No. 75-375

Supreme Court, U. S.
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In the

Supreme Court of the United States

OCTOBER TERM, 1975

WHITE FARM EQUIPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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APPENDIX A

AMERADA HESS CORPORATION, Successor by merger to Hess Oil & Chemical Corporation (J. D. Callendar Financial Vice-Pres.), *Appellant*,

v.

COMMISSIONER OF INTERNAL REVENUE.

AMERADA HESS CORPORATION, Successor by Merger to Hess Oil & Chemical Corporation (Harold N. Blast, Vice-Pres.), *Appellant*,

v.

COMMISSIONER OF INTERNAL REVENUE.

WHITE FARM EQUIPMENT COMPANY, a Delaware Corporation (Successor to Oliver Corporation, a Delaware Corp.)

v.

COMMISSIONER OF INTERNAL REVENUE, *Appellant*.

Nos. 74-1633 to 74-1635.

United States Court of Appeals, Third Circuit.

ARGUED FEB. 27, 1975. DECIDED MAY 13, 1975.

VAN DUSEN, *Circuit Judge*.

On this appeal, Amerada Hess Corporation[1] challenges the Tax Court's determination of a deficiency in Hess'

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[1] Hereinafter "Hess."

income tax payments for 1964 and 1965;[2] the Commissioner appeals the same court's decision[3] that White Farm Equipment Company[4] had overpaid taxes in the years 1960, 1961 and 1962.[5]

The case has its genesis in a routinely complex corporate acquisition. In March 1960, Oliver Corporation,[6] Hess'

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[2] The decision in Docket No. 5842-70 assessed a deficiency for 1964 in the amount of $1,687,232.00. The decision in Docket No. 1367-71 assessed a deficiency for 1965 in the amount of $1,541,601.00. See note 3 *infra*. Hess is appellant in Nos. 74-1633 and 74-1634.

[3] 61 T.C. 189 (1973. Docket Nos. 5842-70 and 1367-71, see note 2 *supra*, were consolidated with Docket No. 4792-69, which involved White Farm's income tax liability. See note 5 *infra*. Since all three docketed cases grew out of a single transaction, the Commissioner filed a motion to consolidate the cases. This motion was granted on May 19, 1970, resulting in a joint trial and one opinion covering all cases.

On March 28, 1974, Amerada Hess filed timely notices of appeal to the Third, Seventh and Eighth Circuits in Docket Nos. 5842-70 and 1367-71. On April 4, 1974, the Commissioner filed timely notices of appeal to the Third and Seventh Circuits in Docket No. 4792-69. Pursuant to 26 U.S.C. § 7482(b), the Commissioner and White Farm filed a stipulation on June 17, 1974, designating the venue of the Commissioner's appeal in the Third Circuit. The appeals of Amerada Hess to the Seventh and Eighth Circuits were dismissed on July 12 and July 1, respectively. On July 29, 1974, this court approved a stipulation entered by all three parties and allowed consolidation of the appeals for purposes of briefing, argument and decision. The Commissioner is appellant in No. 74-1635.

[4] Hereinafter "White Farm."

[5] The decision in Docket No. 4792-69 computed overpayments in the amounts of $425,702.20 (1960), $1,572,710.04 (1961), and $248,059.32 (1962).

[6] Hereinafter "Oliver."

predecessor,[7] and White Motor Company,[8] which owns White Farm,[9] entered into negotiations aimed at the sale of Oliver's farm equipment business[10] to White. The negotiations with White constituted Oliver's third attempt in two years to dispose of its farm equipment business.[11]

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[7] After the transaction which gave rise to the suit, Oliver (referred to by the Tax Court as "Old Oliver"), first changed its name to Cletrac Corporation and then, in 1962, merged with Hess, Inc. to form Hess Oil and Chemical Corporation. In 1969, yet another merger between Hess Oil and Chemical Corp. and Amerada Petroleum Corp. produced Amerada Hess Corp., the appellant in Nos. 74-1633 and 74-1634.

[8] Hereinafter "White."

[9] After the acquisition of its assets and name by White, Oliver Corporation (referred to by the Tax Court as "New Oliver") was a wholly-owned subsidiary of White Motor. In 1969, New Oliver merged with Minneapolis Moline, Inc., the surviving corporation was renamed White Farm Equipment Company. White Farm, the wholly-owned subsidiary of White, is appellee in No. 74-1635.

[10] The manufacture and marketing of farm equipment was Oliver's primary business at the time. See N.T. 194-95.

[11] In 1959, Oliver had "shaken hands" on an agreement for a share exchange with Studebaker-Packard. However, the Studebaker-Packard Board of Directors failed to approve the plan. Just before the negotiations with White began, Minneapolis Moline, another farm equipment manufacturer, proposed a purchase and lease of certain assets. Oliver pursued the White deal to the exclusion of Minneapolis Moline's offer, however. See Exhibit 15-K (Minutes of a Special Meeting of the Board of Directors of the Oliver Corporation, June 23, 1960).

The reasons for Oliver's desire to sell were set forth in its proxy statement, Exhibit 18-N, as follows:

> "The Board of Directors of Oliver has been concerned over the Company's long-range prospects.

[78] Oliver originally sought a cash deal, but when it became apparent that White would not be able to raise enough cash, it was agreed that the bulk of the acquisition price would be paid in White common stock.[12] In order to establish the number of shares which Oliver would receive, the parties had to assign the stock a value. An initial figure of $50.00 per share wass adjusted to $48.50 per share. This latter figure represented the closing price of White common quoted by the New York Stock Exchange on June 23, 1960, the date on which the adjustment in assigned value was proposed.

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[11] (Continued)

> Profits in recent years have not been satisfactory. Earnings in 1959 were slightly under 5% of net worth. Dividends in 1959 were slightly under 2% of net worth. The common stock of Oliver has been selling at a substantial discount under the Stockholders' [78] Investment (net worth or book value). . . .
>
> "The process of improving profit levels of Oliver is a lengthy task. In recent years, Oliver has discontinued or combined several operations in order to eliminate losses, improve efficiency, and release capital. . . .
>
> "As an alternative, the Board of Directors has sought to merge Oliver with another company, or to sell its business to another company, in order to obtain the benefits of the greater efficiency inherent in integrated manufacturing and of an expanded sales organization. In recent years there have been lengthy negotiations with several companies, looking toward merger or sale."

[12] See N.T. 193. White was not to acquire Oliver's cash, accounts receivable, or liabilities, although eventually a very small proportion of Oliver's liabilities was assumed. See N.T. 197. The payment of some cash "boot" was contemplated.

After several months' negotiations,[13] an agreement setting out the terms for White's acquisition of the Oliver

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[13] On June 17, 1960, White submitted its first formal proposal for purchasing "all the tangible assets of The Oliver Corporation . . . held or used in connection with their farm equipment business. . . ." Exhibit 11. Because Oliver's inventory was constantly changing, no dollar amount could be fixed as the purchase price before October 31, 1960, the designated closing date. Therefore, the proposal set forth a formula, based on the book value of the assets to be acquired, for computing the price White would pay for the business. "The purchase price is to be an amount equal to the aggregate sum of the book value (after depreciation) of the fixed assets to be sold plus the book value (on the LIFO basis and after deducting the reserve for obsolescence) of the inventory to be sold, less 20%, of the aggregate sum of the book value of said fixed assets and of said inventory determined as aforesaid." Exhibit 11. The price would be computed on the closing date and would be paid "(a) by the delivery of five hundred thousand (500,000) shares of Common Stock of The White Motor Company, to be considered as having a value of Twenty-five Million Dollars ($25,000,000), and (b) the balance of the purchase price . . . [would] be paid in cash or in debentures at par. . . ." *Id.* White thus valued its shares at $50.00 per share.

Oliver's Board of Directors considered this proposal at its meeting on June 23, 1960. The Board was favorably disposed toward dealing with White, but suggested a change in both the number and the value of the shares offered by White, as shown by this Resolution adopted that date:

> "Resolved, that Alva W. Phelps and A. L. Mailman be, and they hereby are, authorized to continue negotiations with The White Motor Company for the sale of certain assets of the Company to The White Motor Company on the basis of the letter dated June 17, 1960, from J. P. Dragin, Executive Vice President of The White Motor Company, to A. L. Mailman, except that instead of a portion of the purchase price being paid by 500,000 shares of The White Motor Company common stock valued at $50 per

assets [79] was executed on October 3, 1960, subject to approval by shareholders of both corporations.[14] White was

[13] (Continued)

> share, a portion shall be paid by one share of The White Motor Company's common stock for each five shares of The Oliver Corporation's outstanding Common Stock (including that under option), which payment shall be valued on the basis of the closing market price of The White Motor Company stock on June 23, 1960."

No serious attempt to effect the five-for-one stock distribution was made by A. L. Mailman, Oliver's chief negotiator, on Oliver's behalf and it was deleted from the final agreement. N.T. 261. Oliver would accept White shares valued, not at $50.00 per share, but at $48.50 per share, the June 23, 1960, closing price of White common on the New York Stock Exchange. White agreed to the change in valuation.

Due to difficulties which White encountered in obtaining sufficient funds to secure the $20,000,000. of working capital needed for the farm equipment business and to pay the cash "boot" for the acquisition, the number of shares to be received by Oliver was subsequently increased to 655,000. The assigned valuation of $48.50 per share was unchanged, however, even though the stock exchange price of White common had fallen several points since June 23, 1960. See Exhibits 17-M; 18-N.

[14] "14. The Oliver Corporation agrees that it will cause a meeting of its shareholders to be duly called, which will be held not later than October 31, 1960, . . . Said meeting shall be called and held for the purpose of acting upon a proposal to approve and authorize this Agreement and the sale to the White Company of properties and assets of The Oliver Corporation as in this Agreement set forth, for the consideration and upon the terms and conditions in this Agreement provided . . . and The Oliver Corporation agrees that its Board of Directors will do all things necessary or proper on its part to be done to authorize and provide for the carrying out of the provisions of this Agreement and that affirmative action by its shareholders on said proposal will be recommended to its shareholders by its Board of Directors.

to acquire substantially all the working assets of Oliver's farm equipment business[15] in exchange for 655,000 shares of White common stock, plus an amount of cash to be determined as of the closing date. The agreement contained a formula, based on the book value of Oliver's assets, for ascertaining the total dollar price which White was to pay Oliver.[16] The 655,000 [80] shares of stock, at

[14] (Continued)

> "15. The White Company agrees that it will cause a meeting of its shareholders to be duly called, which will be held not later than October 31, 1960 . . . . Said meeting shall be called and held for the purpose of acting upon a proposal to approve this Agreement and the purchase by the White Company of properties and assets of The Oliver Corporation as in this Agreement set forth, for the consideration and upon the terms and conditions in this Agreement provided, and the White Company agrees that its Board of Directors will do all things necessary or proper on the part of the White Company to be done to authorize and provide for the carrying out of the provisions of this Agreement, and that affirmative action by its shareholders on said proposal will be recommended to its shareholders by its Board of Directors."

White Motor Company Proxy Statement, Exhibit 19-O.

[15] See note 12, *supra*. White also acquired Oliver's two foreign subsidiaries, Oliver International, S. A. and The Oliver Corporation, Argentina, S. A.

[16] "7. Subject to the conditions in this Agreement set forth, the White Company agrees to pay to The Oliver Corporation for all of the properties and assets hereinabove described . . . a sum which is equal to the sum of fifty per cent (50%) of the book value, at the close of business on the Closing Date, of the closed South Bend Foundry, plus eighty per cent (80%) of the book value, at the close of business on the Closing Date, of the inventories and, except the closed South Bend Foundry, of the land, land improvements, buildings and improvements, railroad sidings, machinery and equipment, furniture and fix-

the assigned value of $48.50 per share, represented $31,767,-500.00 of the purchase price. If the value of Oliver's assets on the closing date, October 31, 1960, exceeded $31,767,-500.00, White would pay Oliver the difference in cash. Conversely, if the value of the assets was less than $31,-767,500.00, Oliver would pay White the difference in cash. N.T. 84, White Motor Company Proxy Statement, Exhibit 19-O, at p. 3, ¶ (c). Despite the slide in the stock's

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[16] (Continued)

> tures, dies, jigs, fixtures, material handling equipment, patterns, flasks, automobiles, trucks, tractors and other additions in process, purchased by the White Company from The Oliver Corporation under the provisions of this Agreement. The book value at the close of business on the Closing Date, of the property in the preceding sentence described shall be determined in the same manner and by the same accounting methods in all respects, including the LIFO method of taking and pricing inventories and the methods of allowances for obsolescence and depreciation (not including the Reserve for Losses on Fixed Assets in Closed Plants) of fixed assets, as were used and reflected in the 'Consolidated Statement of Financial Position' of The Oliver Corporation and subsidiaries, as of October 31, 1959, which was certified by Arthur Andersen & Co. and included in the '1959 Annual Report' of The Oliver Corporation (except that certain items of consigned inventory may be transferred to trade receivables through note settlements).
>
> "8. The purchase price hereinabove provided for in paragraph 7 shall be paid as follows: The sum of Thirty-one Million Seven Hundred Sixty-seven Thousand Five Hundred Dollars ($31,767,500) shall be paid by the White Company by the delivery, on the Closing Date, to The Cleveland Trust Company, of Cleveland, Ohio, of certificates for six hundred fifty-five thousand (655,000) shares of the Common Stock of the White Company, made out and registered in the name of said The Cleveland Trust Company, or its nominee, to be held and disposed of by said Trust Company as provided in the Trust Agreement . . . .

quoted price between June 23 and October 3, the parties made no attempt to renegotiate the $48.50 per share figure. The assigned value continued to fix the portion of the purchase price Oliver would receive in stock and, thereby, to determine the amount of cash that would change hands. However, neither the written agreement nor any negotiations predating that agreement indicated that the assigned value had any tax or accounting significance.[17]

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[16] (Continued)

> As soon as practicable after the Closing Date, the purchase price of the properties and assets . . . at the close of business on the Closing Date, shall be computed in the manner hereinabove . . . provided, and thereupon the White Company shall forthwith pay to The Oliver Corporation the unpaid balance, if any, of said purchase price, as so computed, by check payable to the order of The Oliver Corporation. If the said computation shall show that the purchase price is less than Thirty-one Million Seven Hundred Sixty-seven [80] Thousand Five Hundred Dollars ($31,767,500), The Oliver Corporation shall forthwith pay to the White Company by The Oliver Corporation's check the difference between the said purchase price and the said sum of Thirty-one Million Seven Hundred Sixty-seven Thousand Five Hundred Dollars ($31,767,500)."

Id.

[17] Indeed, there were indications in both companies' proxy statements that the $48.50 valuation was not meant to control for tax or accounting purposes. As J. P. Dragin, White's chief negotiator, recognized in his trial testimony, N.T. 75, the notes to the pro forma balance sheet included in White's proxy materials implied that the market value on the closing date would control for accounting purposes:

> "NOTE C—The pro forma adjustments are as follows:
>
> "(2) These amounts represent the excess of Oliver book value over White acquisition cost. The amount of excess will be adjusted for the difference between the assigned value of $48.50 per share of White common stock and its market value on the closing date.

[81] Besides terms relating to the purchase price, the agreement included a Trust Agreement. The White shares

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[17] (Continued)

"(3) Issuance of 655,000 shares of common stock at an assigned value of $48.50 per share, or an aggregate of $31,767,500, of which the sum of $1.00 per share is credited to the Common Stock Account and the sum of $47.50 per share is credited to Capital in Excess of Par Value of Capital Stock. The aggregate credit to Capital in Excess of Par Value of Capital Stock of $31,112,500 is subject to a decrease or an increase in the same amount as the adjustment to the excess referred to in Note C(2) above."

Exhibit 19-O, Note C, at page 20. The Oliver proxy materials also indicated that the market price on the closing date would control for tax purposes:

"Among other things, they are subject to variations in inventories (including inventories to be sold to White), trade receivables, bank debt, other items, profit or loss for the period from July 31, 1960, to October 31, 1960, tax adjustments which may arise from the difference between the assigned value of $48.50 per share of White common stock and its fair value on the Closing Date, and matters which are not foreseen by the Directors at this time. A decline in the value of the White common stock prior to the Closing Date will increase the loss on the sale. This increase in loss would amount to $4,912,500 if that value were the closing market price of White common stock on September 26, 1960. In addition, as indicated on page 4, the Closing Date may be a date later than October 31, 1960. Oliver makes no representation as to what the market value of White common stock will be at the Closing Date.

"(1) In October, 1960, the Company entered into an agreement with The White Motor Company providing for the sale of the farm equipment business and certain related assets of Oliver to White. Under the terms of the agreement, the assets of Oliver to be sold would be exchanged for 655,000 shares of the common stock of White at an assigned value of $31,-

were to be held in trust until they were either distributed pro rata to Oliver shareholders, in exchange for Oliver common stock, or sold.[18] Should the shares be sold, no

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[17] (Continued)

767,500, and for cash estimated at $9,045,000 depending on the book value of the assets at the closing date. The aggregate market value of White common stock to be issued was $4,912,500 less than the assigned value thereof based on the closing price of White stock on the New York Stock Exchange on September 26, 1960.

"Based upon the table on page 7, prepared by the Company, the net book value as of July 31, 1960, of the assets to be sold ($51,410,000) exceeds the sum of the estimated cash and the market value of the 655,000 shares of White stock to be received. As discussed on page 8, the ultimate loss on the transaction is dependent upon the book value of the assets to be sold, the Federal income tax status of the company and the fair value of White common stock at the closing date, which is expected to be October 31, [81] 1960, and the determination of reserve adjustments that may be required at that date. No recognition has been given in the accompanying consolidated financial statements and the summary of consolidated earnings to this potential loss on sale of assets."

[18] Distribution to Oliver shareholders was dependent upon Oliver's receiving an Internal Revenue Service ruling to the effect that such a distribution would be taxed to the shareholders as a capital gain or loss, rather than as an ordinary dividend. The ruling was received and distribution of White stock to Oliver's shareholders began on July 31, 1961. The Tax Court found that "approximately 653,770 shares of the block of 655,000 shares were either distributed directly to the Old Oliver shareholders or sold on the market and the proceeds made available to the shareholders. The remainder . . . was held by Old Oliver as an investment." 61 T.C. at 205.

more than 10,000 shares could be acquired by any one purchaser.[19]

At special shareholders' meetings held on October 31, 1960, the shareholders of both White and Oliver approved the agreement. On that date, Oliver transferred its assets to White; in return, White delivered the 655,000 shares to the trustee, paid Oliver $1,508,550.00 in cash, and assumed $281,396.00 of Oliver's liabilities.[20] White common traded on the New York Stock Exchange at an average price of $36.3125 on October 31. White initially recorded the Oliver assets on its books in an amount which reflected a per share valuation of $36.3125. However, before closing its books for 1960, White was advised by its accountants[21] to carry the assets at a figure reflecting the assigned valuation of $48.50 per share. White accordingly adjusted the entries to correspond with the higher, assigned value. Oliver[22] entered the White common on its books at an aggregate value of $23,784,688.00, which represented a per share price of $36.3125. No alterations were made in this entry.

26 U.S.C. §1001(b) provides, *inter alia*, that the "amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair

[19] The 10,000 share restriction was included to prevent any one individual from buying a sufficient number of shares to obtain working control of White. The 655,000 shares acquired by Oliver represented 23.7 per cent of White's outstanding stock.

During the time the trustee held the shares pending distribution, the stock was to be voted pro rata according to the instructions of Oliver's shareholders. Oliver's directors had no power to vote as a block the shares held by the trustee.

[20] See note 12, *supra*.

[21] See N.T. 89, 91; 61 T.C. at 204.

[22] As a result of shareholder ratification of the agreement, Oliver's name was changed to Cletrac Corporation on October 31.

market value of property (other than money) received." The amount realized by both parties to the acquisition was thus determined by the fair market value of the White common stock. Since the amount realized in turn determined the taxes which each party owed on the transaction, the fair market value was the factor controlling the parties' tax liability. White's[23] federal income tax returns for 1960, 1961, and 1962 reported income from the Oliver acquisition on the basis of the $48.50 per share valuation. Oliver employed the October 31 average market price of $36.3125 per share in reporting a loss from the sale of its farm equipment business on its 1960 federal income tax return. Subsequently, the Commissioner determined that both parties had underpaid their taxes on income attributable to the transaction. The fact and amount of underpayment by each party hinged on the fair market value of the White shares. See 26 U.S.C. § 1001(b). Assessing a deficiency against both White Farm,[24][82] White's successor, and Hess, Oliver's successor,[25] required the Commissioner to take inconsistent positions concerning the correct valuation of the shares. Thus the Commissioner maintained in one case that White Farm had erred in pricing the White common at $48.50 per share, while arguing in the second case that Hess had erred in failing to assign the stock the same value. Since prosecuting both cases separately[26] might well have resulted in contradictory valuations of the shares, the cases

[23] These returns were actually filed by White's farm equipment subsidiary, which eventually became White Farm. See note 9, *supra*.

[24] See note 9, *supra*. The deficiency was actually assessed against Oliver Corporation, but the case caption was amended when Oliver became White Farm.

[25] See note 7, *supra*.

[26] White Farm's predecessor, Oliver, filed its petition appealing from the Commissioner's assertion of a deficiency in its tax on September 22, 1969. Amerada Hess filed its petition on September 8, 1970.

were consolidated for trial in the Tax Court.[27] The Commissioner's position was essentially that of a stakeholder whose "primary concern" was that the shares be valued consistently as to each party. 61 T.C. at 206. However, in his briefs in the Tax Court and this court, as well as at oral argument before this court, the Commissioner adopted Hess' position, urging that "the best evidence of the fair market value of the White stock is its mean trading price on the New York Stock Exchange on the closing date, October 31, 1960." 61 T.C. at 214. The Tax Court rejected this argument in holding that the value of the shares was that assigned by the parties in their October 3 agreement, i.e., $48.50 per share. Both the Commissioner and Hess appeal from that holding. We reverse.

The primary question on appeal concerns the proper method for measuring the fair market value of shares traded on a stock exchange. Both appellants contend that the average exchange quotation on the valuation date—in this case, $36.3125 per share—is the best evidence of fair market value. Hess further argues, as a secondary issue, that the market price on October 31, 1960, should be discounted to compensate for a blockage factor. We consider these assertions seriatim.

I. FAIR MARKET VALUE

A. *Standard of Review*

As a threshold matter, we must determine the scope of review open to us on this appeal. White Farm, claiming that the Tax Court's determination of fair market value is "purely one of fact," Brief of Petitoner-Appellee at 14, would have us limit our inquiry to whether that determination is "clearly erroneous." The computation of the actual dollar worth of the stock is concededly a question of fact. The question for decision, however, is whether the Tax Court "failed to use correct standards of valuation applicable to the [factual] situation which it

[27] See note 3, *supra*.

found." *Richardson* v. *Commissioner,* 151 F.2d 102, 103 (2d Cir. 1945). In choosing one *method* of valuation, the Tax Court set a legal standard, which is to be reviewed as such. See *Churma* v. *United States Steel,* 514 F.2d 589 (3d Cir. 1975); *Katz* v. *Carte Blanche,* 496 F.2d 747, 756-57 (3d Cir. 1974). As this court observed in *Publicker* v. *Commissioner of Internal Revenue,* 206 F.2d 250, 252 (3d Cir. 1953), cert. denied, 346 U.S. 924, 74 S.Ct. 312, 98 L.Ed. 418 (1954),

> "The criteria to be employed in determining 'value' necessarily must differ somewhat in respect to the kinds of property to be valued under the statute. A question of law is presented therefore as to the standard to be applied. See Powers v. C. I. R., 1941 312 U.S. 259, 260, 61 S.Ct. 509, 85 L.Ed. 817. But the Tax Court's determination of value, the proper standard having been applied by it, is a finding of fact. This finding, based upon the resolution of conflicting evidence, may not be disturbed unless clearly erroneous."[28]

[83] B. *The General Rule and Its Exceptions*

There is no real dispute as to the *definition* of "fair market value." N.T. 448; 493-94, 501. According to the classic formulation, "[f]air market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." *United States* v. *Cartwright,* 411 U.S. 546, 551, 93 S.Ct. 1713, 1716, 36 L.Ed.2d 528 (1973), quoting Treas.Reg. §20.2031-1(b). S. Alfred, Fair Market Value Concept: General Considerations, 14 W.Res.L.Rev. 173, 175 (1963). The dispute in this case is over the application of the definition and, more specifically, over the proper method by which that ideal

[28] But see Seas Shipping Co. v. Commissioner, 371 F.2d 528, 529 (2d Cir.), cert. denied 387 U.S. 943, 87 S.Ct. 2076, 18 L.Ed.2d 1330 (1967).

price can be measured under less than ideal conditions. Since "the word 'value' almost always 'involves a conjecture, a guess, a prediction, a prophecy,'" *Andrews* v. *Commissioner,* 135 F.2d 314, 317 (2d Cir.), cert. denied, 320 U.S. 748, 64 S.Ct. 51, 88 L.Ed. 444 (1943), quoting, *Commissioner* v. *Marshall,* 125 F.2d 943, 946 (2d Cir. 1942), there is no universally infallible index of fair market value. All valuation is necessarily an approximation. Where, however, the property to be valued consists of securities traded on a stock exchange, the general rule is that the average exchange price quoted on the valuation date[29] furnishes the most accurate, as well as the most readily ascertainable, measure of fair market value. *United States* v. *Cartwright,* 411 U.S. 546, 551, 93 S.Ct. 1713, 36 L.Ed.2d 528 (1973); *Hazeltine Corp.* v. *Commissioner,* 89 F.2d 513, 519 (3d Cir. 1937); *Richardson* v. *Commissioner,* 151 F.2d 102, 103 (2d Cir. 1945), cert. denied, 326 U.S. 796, 66 S.Ct. 490, 90 L.Ed. 485 (1946); *Andrews* v. *Commissioner,* 135 F.2d 314, 318 (2d Cir.), cert. denied, 320 U.S. 748, 64 S.Ct. 51, 88 L.Ed. 444 (1943); *Rogers* v. *Helvering,* 107 F.2d 394, 396 (2d Cir. 1939); *W. T. Grant Co.* v. *Duggan,* 94 F.2d 859, 861 (2d Cir. 1938); *Southern Natural Gas Co.* v. *United States,* 412 F.2d 1222, 1252, 188 Ct.Cl. 302 (1969); Porter, The Cost Basis of Property Acquired by Issuing Stock, 27 Tax Lawyer 279, 281 (1973-74); Alfred, *supra* at 175-76; Bonbright, Valuation of Property, Vol. II, 1023 (1937); *cf. Bankers Trust Co.* v. *United States,* 459 F.2d 484, 1989 Ct.Cl. 306 (1972). In *Hazeltine, supra* at 519, this court said:

> "The Board seems to have ignored the evidence of fair market value furnished by the sales upon the Curb Exchange and in this we think it fell into error. The primary evidence of the fair market value of corporate stock is what willing purchasers

[29] There is no dispute that the correct valuation date is October 31, 1960.

> pay to willing sellers on the open market, even though the assets of the corporation do not reflect such values. . . . In the present case, however, the evidence indicated a large volume of trading in these shares in a market which was fair and open and not distorted by any abnormal conditions or factors. . . . In the light of these facts we are of opinion that the fair market value of the shares on February 19th was conclusively established by the evidence of the sales which took place on the Curb Exchange on that day."

There are, of course, exceptions to this general rule. The assumption underlying the concept of tfhe market as an index for valuing particular property is that the property to be valued is substantially similar to the property actually sold on the market. Heiner v. Crosby, 24 F.2d 191, 193 (3d Cir. 1928). Where the market exhibits such peculiarities as cast doubt upon the validity of that assumption, the market price must be either adjusted or discarded in favor of some other measuring device, such as the "intrinsic value" or "barter-equation" method.[30] Thus, where the market [84] reflects only "sales of small lots, forced sales, and sales in a restricted market, [it] may not furnish evidence of fair market value." *Hazeltine, supra* at 519; *Heiner* v. *Crosby, supra.* Similarly, where the stock price on the valuation date is so markedly "out of line with its price on the said Exchange throughout the year straddling the critical date" as to be aberrational, another index may be preferable. *Richardson* v. *Commissioner, supra* at 103.[31]

[30] "Intrinsic value" refers to a valuation based on the underlying asses and earnings of a business. "Book value" is a type of intrinsic value. According to the "barter-equation" approach, the value of property given up in an exchange is computed by equating it to the [84] value of the property received in the same exchange.

[31] The market may also be an inappropriate measure because the *type* of stock traded on the exchange differs

Also, stock which is subject to restrictions on alienation or voting rights is likely to be valued either at a discount from market price. *LeVant* v. *Commissioner,* 376 F.2d 434 (7th Cir. 1967), or according to another valuation method. *E. G. Rodman,* 57 T.C. 113 (1971). Adjustment of the market price is necessary for stock which carries "extras," such as control or additional voting rights,[32] as well as for exceptionally large blocks of stock which lack these "extras."[33] *Commissioner* v. *Stewart's Estate,* 153 F.2d 17 (3d Cir. 1946); *Richardson, supra.* The better view is that the market does provide the best evidence of value, notwithstanding a depressed state, or even a large-scale manipulation, of the market as a whole. Market cycles and susceptibilities are, after all, part of the risk which the trader assumes and which is one of the determinants of value. *Andrews* v. *Commissioner, supra; W. T. Grant Co.* v. *Duggan, supra.* But see *Strong* v. *Rogers,*

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[31] (Continued)

from the type traded by the parties to the particular transaction. In Ray Cooper Co. v. United States, 268 U.S. 373, 45 S.Ct. 526, 69 L.Ed. 1003 (1925), the Court held that it was not error to use the value of corporate assets rather than the market to fix the value of capital stock, since "[t]he capital stock of a corporation . . . and its shares of stock are entirely different things. The value of one bears no fixed or necessary relation to the value of the other." *Id.* at 377, 45 S.Ct. at 528 (citations omitted).

[32] In such a situation, the market price is enhanced by a "control premium."

[33] Selling off a very large block of shares which are identical to all other such shares available on the market creates a supply in excess of demand. It is widely accepted that the market quotation of such shares should be reduced to compensate for this price-depressing effect. The reduction is referred to as a "blockage discount."

72 F.2d 455, 457 (3d Cir.), cert. denied, 293 U.S. 621, 55 S.Ct. 217, 79 L.Ed. 709 (1934).[34]

Even in the "exceptional" situation, the market price may provide the best point of departure for valuing securities. Market analysts have developed reliable techniques for determining the amount by which the market price should be adjusted to correct for various abnormalities. Where such techniques are relevant, they can be used to adapt the market price so that it sets the fair market value with considerable accuracy.

The Tax Court, however, neither adopted nor adapted the market price as the proper index of valuation in this case. It held, rather, that the valuation assigned by the parties was commensurate with fair market value within the meaning of 26 U.S.C. § 1001(b). That the court thus rejected the market pricing mechanism in favor of the "barter-equation method" of valuation is clear from the fact that the assigned value was an aliquot portion of the agreed purchase price for the Oliver assets. As authority for choosing the barter-equation method, the court relied exclusively upon cases dealing with the valuation of "exceptional" property.[35]

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[34] In Strong v. Rogers, this court held that the "wild and unreasonable" market prices during 1927-1929 did not conclusively establish the correct income tax valuation, as they failed to fix a "fair" market value. This view has been disapproved by the commentators. *See* Porter, *supra* at 283; Bonbright, *supra* at 1022.

[35] The Tax Court cites "W. E. Telling Est., a Memorandum Opinion of this Court dated June 28, 1944, where the Court held that negotiations for the sale of stock at a price in excess of the stock's trading price on the Cleveland Exchange controlled the fair market value of the stock for estate tax purposes." Whatever other distinctions may exist between *Telling* and the present case, it suffices to observe that "memorandum decisions . . . are not generally cited as authorities by the [85] Tax Court or other courts, and are intended to involve questions turning on fact issues

[85] C. *The Tax Court Holding*

[4] Most of the cases cited by the Tax Court involved the valuation of property for which no established market existed.[36] In such cases, of course, there is no

[35] (Continued)

or previously decided points." Surrey, Warren, McDaniel and Ault, Federal Income Taxation, Vol. I, 64 (1972). Moreover, Richard E. Wiles, Jr., 60 T.C. 56, 63 (en banc) (1973), aff'd on other grounds, 499 F.2d 255 (10th Cir. 1974), cert. denied, 419 U.S. 996, 95 S.Ct. 310, 42 L.Ed.2d 270 (1974), rejected the argument, which was raised by the Commissioner in that case, that the agreed values for stock should be used to compute the amount realized. In *Wiles,* the Tax Court clearly took the position that "we cannot subscribe to the suggestion that petitioner and [his wife] could have valued those stocks more accurately than the highly organized markets in which they are traded daily. Indeed, cases cited by the Commissioner state that the fair market value of a publicly traded stock is the average of the market high and low upon transfer."

[36] *See, e.g.,* Ray Copper Co. v. United States, 268 U.S. 373, 45 S.Ct. 526, 69 L.Ed. 1003 (1925), cited at 61 T.C. 214 (capital stock having no market); Bar L Ranch, Inc. v. Phinney, 426 F.2d 995 (5th Cir. 1970), cited at 61 T.C. 213 (valuation of notes or accounts receivable of an insolvent obligor, there being no market for such paper); Ullmann v. Commissioner, 264 F.2d 305 (2d Cir. 1959), cited at 61 T.C. 209 (involving the characterization and valuation of a covenant not to compete—a commodity also lacking a market on the exchange or over the counter); Glen W. Lucas, Jr., 58 T.C. 1022 (1972); Edmond E. Maseeh, 52 T.C. 18 (1969), cited at 61 T.C. 211 (also involving covenants not to compete); Southern Natural Gas Co. v. United States, 412 F.2d 1222, 188 Ct.Cl. 302 (1969), cited at 61 T.C. 208 ("The preferred stock in question was newly issued and was neither listed on any exchange nor traded over the counter. Such private sales as had occurred were insignificant. Accordingly, it had no established or readily ascertainable market value or price . . . other than the value assigned to the shares by the contracting parties."), 412 F.2d at 1250-51.

opportunity to resort to market prices and other means of valuation must be employed. Yet on the basis of these cases, the Tax Court required Hess, as "the taxpayer attacking an assigned value in an agreement to which he was a party," to "prove that the valuation had no basis in fact or business reality and did not represent the actual intention or agreement of the parties." 61 T.C. at 211. Moreover, the same burden was placed on the Commissioner. *Id.* The court itself acknowledged that "the usual application of the 'strong proof' rule is to an assigned valuation of a covenant not to compete in a sales agreement," but found "the rule equally applicable to the instant transaction where the parties assign a value to shares of stock." *Id.* The authority cited for this latter proposition is readily distinguishable.[37] It is likewise obvious that *only* the parties to such a covenant could value it; there exists no outside valuation index. More importantly, however, the proposition itself ignores the reason behind requiring "strong proof" in cases where one party to an agreement which sets the value of a covenant not to compete subsequently seeks to avoid the agreement by challenging either the valuation or characterization of the covenant. This court, in requiring an even more stringent standard than "strong proof" in such cases, enunciated the following rationale for holding the parties to their bargain unless that bargain is infected with fundamental error:

[37] Authority for this proposition is Judge Friendly's concurrence in Seas Shipping Co. v. Commissioner, 371 F.2d 528 (2d Cir.), cert. denied, 387 U.S. 943, 87 S.Ct. 2076, 18 L.Ed.2d 1330 (1967), which is distinguishable because the parties' agreed price was, in that case, also found reasonable by the Maritime Commission. In Estate of Rogers v. Commissioner, 445 F.2d 1020 (2d Cir. 1971), also relied on by the Tax Court, the question was the fair market value of real estate and of a mortgage on real estate—items with no clear market such as that for fungible goods.

"We begin by noting that the determination as to whether a covenant not to compete was actually executed is important, taxwise, both to the buyer and the seller. . . . Indeed, the presumed tax consequences of the transaction may, as here, help to determine the total amount a purchaser is willing to pay for such a purchase. [86] Therefore, to permit a party to an agreement fixing an explicit amount for the covenant not to compete to attack that provision for tax purposes, absent proof of the type which would negate it in an action between the parties, would be in effect to grant, at the instance of a party, a unilateral reformation of the contract with a resulting unjust enrichment. . . . And to go behind the agreement at the behest of a party may also permit a party to an admittedly valid agreement to use the tax laws to obtain relief from an unfavorable agreement.

"Of vital importance, such attacks would nullify the reasonably predictable tax consequences of the agreement to the other party thereto. . . . In the future buyers would be unwilling to pay sellers for tax savings so unlikely to materialize.

"Finally, this type of attack would cause the Commissioner considerable problems in the collection of taxes. The Commissioner would not be able to accept taxpayers' agreements at face value. He would be confronted with the necessity for litigation against both buyer and seller in order to collect taxes properly due. This is so because when the Commissioner tries to collect taxes from one party he may, as here, dispute the economic reality of his agreement. When the Commissioner turns to the other party, there will likely be the arguments that the first party, as here, received consideration for bearing the tax burden resulting from the sale and that the covenants did indeed have economic reality.

"For these reasons we adopt the following rule of law: a party can challenge the tax consequences of his agreement as construed by the Commissioner only

by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc."

Commissioner v. *Danielson*, 378 F.2d 771, 775 (3d Cir. 1967). Because this rationale, common to *Danielson* and the "strong proof" cases, is not germane to the facts of this case, neither the *Danielson*[38] rule nor the "strong proof" rule determines the appellants' burdens here.[39]

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[38] The *Danielson* court also implied that a valuation agreement could be freely attacked by the Commissioner—an implication which runs counter to the Tax Court's reasoning in the present case.

"Next, we are not here involved with a situation where the Commissioner is attacking the transaction in the form selected by the parties, ... Where the Commissioner attacks the formal agreement the Court involved is required to examine the 'substance' and not merely the 'form' of the transaction. This is so for the very good reason that the legitimate operation of the tax laws is not to be frustrated by forced adherence to the mere form in which the parties may choose to reflect their transaction. . . . In contrast, the Commissioner here is attempting to hold a party to his agreement unless that party can show in effect that it is not truly the agreement of the parties. And to allow the Commissioner alone to pierce formal arrangements does not involve any disparity of treatment because taxpayers have it within their own control to choose in the first place whatever arrangements they care to make."

378 F.2d at 774-75 (citations omitted). The Tax Court, finding that appellants had failed to meet the looser "strong proof" standard, did not decide whether *Danielson* applied. 61 T.C. at 211.

[39] As justification for its use of both the "strong proof" standard and the "barter-equation method" of valuation, the Tax Court relied primarily on *Seas Shipping Co., supra.* In *Seas Shipping*, the Second Circuit, reluctantly, affirmed the Tax Court's use of the barter-equation method to value shares of Moore-McCormack Lines (Mooremac) which were traded on the New York Stock Exchange.

[87] In addition to finding that the appellants had failed to establish by strong proof that the agreed valua-

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[39] (Continued)

Seas Shipping is, however, distinguishable from the case now before this court in several significant respects.

At the time the parties agreed to value the Mooremac stock at $30.00 per share, the exchange price of the stock was approximately $23.00 per share. Although the block of 300,000 shares comprised "a 13% ownership in a successful corporation and was the largest [87] block held by any Mooremac shareholder," the block "did not represent a controlling interest." 371 F.2d at 530. However, as part of the deal, Seas Shipping executed "a contemporaneous voting trust agreement . . . with certain Mooremac shareholders by which [Seas] received control of two directorships on Mooremac's board of ten for a period of five years. . . ." *Id.* This agreement was found by the Tax Court to enhance the value of the shares Seas acquired; the court of appeals saw this factor as a mere makeweight. Other factors considered by the court to support the $30.00 per share agreed value were (1) "Mooremac had agreed to continue, under the same name, the shipping line previously operated by [Seas] and to hire certain of [Seas] employees," 371 F.2d at 530; (2) "the book value of Mooremac shares during 1957 was in excess of $39," *id.;* (3) "the annual market of 166,000 shares was too 'thin' to fix the value of a block of 300,000 shares," *id.;* (4) "testimony concerning the value of the ships was ample and convincing," 371 F.2d at 532; (5) "the Maritime Board in its approval of the sale of the ships, stated that the value of the stock was $30 per share," 371 F.2d at 531. This latter consideration was accorded weight by Judge Friendly in his concurrence at 371 F.2d 533. By contrast, the Tax Court in the present case relied almost entirely on the parties' evaluation. Of the factors which supported the validity of the agreed share price in *Seas Shipping,* only the thinness of the market arguably applies in the present case and this cannot be, alone, determinative. See p. 21, *infra.* In particular, the testimony as to asset value in this case cannot be characterized as either ample or convincing, as it was in *Seas Shipping.* See note 44, *infra.*

tion did not represent the stock's fair market value for tax purposes, the Tax Court suggested that exceptional circumstances made the market price an inaccurate index of value in this case. 61 T.C. at 215. One of the circumstances the Tax Court identified was that "[o]nly 3,300 shares of White shares were traded on the date of sale. . . ." *Id.* However, that trading volume was in no way aberrational as compared with the daily volume throughout 1960, see Exhibit 17-M, and therefore provides no ground to reject the stock market price as an accurate value index. See *Richardson* v. *Commissioner,* 151 F.2d 102 (2d Cir. 1945), cert. denied, 326 U.S., 796, 66 S.Ct. 490, 90 L.Ed. 485 (1946). The Tax Court also observed that "the trading price [on October 31, 1960] . . . was the lowest price at which the stock traded in 1960 and 1961." *Id.* That price, less than a point below the average selling price on several subsequent days, was not radically out of line with the average exchange quotations in the months immediately preceding the valuation date. There was, moreover, uncontroverted testimony that the market for White common on October 31, 1960, was not an aberrational one. The expert witnesses who testified on this point viewed the steady decline in the price of the stock after June 23 as part of an overall market downturn occasioned by the poor business climate in 1960 and aggravated by the approach of the Presidential election. N.T. 465; 485. In addition, "White was not having a good year, and they were bringing off a fairly large transaction that year [the Oliver acquisition] which added an element of uncertainty to the situation." N.T. 465. The uncontradicted evidence establishes that the market price on October 31, 1960, was not aberrational, either in terms of a range of contemporaneous quotations on White shares or in terms of the performance of the whole market. The mere fact that the October 31 value was the lowest quoted in 1960 was thus an insufficient basis for rejecting this market price as the fair market value of the stock.

Relying on *Seas Shipping Co., supra.*[40] the court noted that the market measure was inapposite because of the size of the block relative to the total exchange volume during 1960—655,000 shares as against 444,000. 61 T.C. at 211. In *Seas Shipping*, the size of the block was only one factor which led the court to reject the market price. 371 F.2d at 531-32. Moreover, in that case the block to be valued was almost twice as large as the annual market volume. In the present case, by contrast, the [88] large size of the block is the *only* exceptional attribute of the stock exchanged for the assets.[41] Moreover, the blockage discount, see Part II *infra*, offers a suitable corrective for the fact that one-third more shares were received by Oliver than were traded on the exchange in 1960. Under these circumstances, we hold that the Tax Court erred in resorting to the "barter-equation method" to fix the fair market value of the White stock. The correct course was to value the shares at the mean exchange price on October 31, 1960, allowing a discount for blockage, if relevant on these facts. In reversing, we emphasize that the weakness of the Tax Court holding is not confined to its reliance on distinguishable precedent. More fundamentally, the agreed valuation method adopted by the court creates difficulties which are avoided by using the stock exchange price as the primary basis for determining value.

D. Difficulties created by adopting the agreed valuation as the measure of fair market value in this case.

1. *Purpose of the Valuation*

It is axiomatic that the same item may have different "value" for different purposes. *LeVant* v. *Commissioner*,

[40] See note 39, *supra.*

[41] The only effect of the restriction as to the number of shares that might be sold to a single purchaser was to negate any control possibilities. See note 19, *supra.* This restriction does not, therefore, qualify as an "exceptional" attribute.

supra at 442; Fiflis & Kripke, Accounting for Business Lawyers, 141 (1971). The Tax Court implicitly recognized this principle by finding both an agreement between the parties to value the stock at $48.50 per share, 61 T.C. at 206, and no discussion as to the accounting or tax value of the same stock. 61 T.C. at 192.[42] The effect of the Tax Court holding, however, is to equate these different values. We disagree with the Tax Court's conclusion that the parties' valuation of stock, reached for purposes of establishing the terms of payment for Oliver's assets, is determinative of the fair market value for tax purposes. There are certainly circumstances under which assigned and tax values can—or must—be equated. See, *e.g.*, cases cited note 36, *supra.* Nevertheless, the difference in valuation purposes should render a court cautious in assuming value equivalency. The Tax Court exhibited no such caution.

2. *Difficulties in Valuation*

The Second Circuit sustained the Tax Court's use of the barter-equation method for valuing the stock in *Seas Shipping, supra*, only because it was unable to find that method of valuation clearly erroneous under the circumstances. 371 F.2d at 529, 532.[43] The court cautioned that the barter-equation method ought to be used

> ". . . only under certain limited conditions. . . . There are obvious dangers in evaluating the consideration involved on one side of a barter by determining the worth of the consideration on the other side. In the first place, the two sides of the barter may, for various reasons, not be equal in value. Secondly, the barter-equation method is in the nature of a bootstrap operation since there is usually no logical reason to start with one side rather than the other.

[42] Both findings are unimpeachable under the "clearly erroneous" rule. See Commissioner v. Duberstein, 363 U.S. 278, 289-91, 80 S.Ct. 1190, 4 L.Ed.2d 1218 (1960).

[43] See Part I-A, *supra.*

. . . Thirdly, the evidence on the value of one side of a barter may be no more reliable than that on the value of the other side."

371 F.2d at 529-30.

These warning words are particularly apt in this case, where there was no evidence that the valuation of Oliver's assets by the parties was in any degree [89] more sound that the market's valuation of White's shares."

" In fact, there was evidence that strongly implied the opposite. The aggregate book value of the assets was $42,905,763.00.

"Assets Acquired	Old Oliver's Book Value at October 31, 1960	Purchase Price Computed in Accordance with Paragraph 7 of the October 3, 1960 Agreement
1. Real estate on which plants were located.	$ 3,698,551	$ 2,958,840
2. Machinery and equipment in the plants.	$ 7,755,727	$ 6,182,976
3. Real estate on which branches were located.	$ 2,861,343	$ 2,207,120
4. Machinery and equipment in the branches.	$ 479,462	$ 383,570
5. Tooling.	$ 3,905,740	$ 3,124,593
6. Inventory.	$23,777,820	$19,022,256
Subtotal	$42,478,643	$33,879,355
Prepaid Expenses	$ 427,120	$ 336,091
TOTAL	$42,905,763	$34,215,446"

Statement of John Peter Dragin, p. 6, Tax Ct. Docket Nos. 4792-69 and 5842-70.

II. BLOCKAGE DISCOUNT

The Tax Court's holding obviated the necessity for it to decide whether Hess was correct in arguing that the

" (Continued)

The purchase price computed according to paragraph 7 of the October 3, 1960, agreement, see note 16, *supra,* was $34,215,446. Kriser, who appraised some of the assets for White, attached to the real estate, plants, and equipment a "liquidating value" price. Kriser's statement noted that " 'liquidating value' is to be distingushed from 'fair market value.' . . . Liquidating value is similar to fair market value, except that a reasonable time to find a purchaser is not allowed. It generally restricts the class of buyers to spontaneous buyers—those who would attend an auction sale and buy on the spot, after only a short period of inspection or thought." Statement of Sidney P. Kriser, Tax Court Docket Nos. 4792-69 & 5842-70, at 5.

J. P. Dragin, who also inspected the same assets, averred that, in his experience, "fair market values [of real estate] were higher than book values due to increasing costs and rising real estate values." Statement of John Peter Dragin, Tax Court Docket Nos. 4792-69 & 5842-70, pp. 9, 7. He also admitted that he had made no "effort to inspect and appraise the branch machinery and equipment to the extent we did the other assets" because the agreed purchase price of $383,570.00 "was minor in relation to the total transaction." *Id.* at 9. Dragin also stated that the book value of the tooling, which was in excess of the agreed purchase price, was "conservative and considerable amounts of tooling having no book value could still be used in production and would have substantial value . . . ." *Id.* at 11. The inventory, for which White agreed to pay $19 million, had a book value of approximately $24 million. Dragin found its replacement value to be approximately $32 million. These examples of the diverse views of, and approaches to, the value of these various assets underscore the complexity of asset valuation. They also raise questions as to the solidity of the basis for the Tax Court's conclusion that "the value assigned in the . . . agreement . . . constitutes a much more reliable measure of the value of those shares" than the market place. 61 T.C. at 215.

market price of $36.3125 should be adjusted by a blockage discount.[45] Hess reasserted this contention on appeal.

At oral argument, the Commissioner conceded that the proper valuation of the stock would entail discounting the relevant market price by a blockage factor. The Commissioner further acknowledged that the fair market value of the White common was that which the Internal Revenue Service expert had testified to at trial: $30.85 per share. We have considered White Farm's objection to allowing the blockage discount and reject it.[46] See *Stewart's Estate, supra* at 18-19, and other cases cited at pages 14-15, *supra*. There is thus no need to remand for a determination of the blockage discount issue.

For the foregoing reasons, the decision of the Tax Court will be reversed, with [90] directions to that court to enter judgment consistent with this opinion.

JAMES HUNTER, III, Circuit Judge (concurring in part and dissenting in part):

Although I am in substantial agreement with the majority opinion, I cannot agree with the majority's substitution of its views for those of the tax court on the applicability of blockage. As a result, I must dissent from Part II of the opinion.

Whether the blockage effect is relevant to the value of a security in any given case is a question of fact, *Commissioner* v. *Stewart's Estate,* 153 F.2d 17 (3d Cir., 1946); *Richardson* v. *Commissioner,* 151 F.2d 102 (2d

[45] Even though the Tax Court did not have to decide the issue, it appeared to disagree that the blockage discount and the values assigned that discount by the experts' testimony were relevant in this case. See 61 T.C. at 215-16.

[46] Although the Tax Court expressed doubt as to the validity of the experts' methods of computing the discount, there was no contradictory testimony to discredit these valuations by several experts who reached very similar conclusions. See N.T. 342, 346-47; 349; 357-59; 443, 447-48; 453-65; 472-80, 492-502.

Cir., 1945); *Helvering* v. *Maytag,* 125 F.2d 55 (8th Cir., 1942).[1] As such, an appellate court may not disturb the findings of the trier of fact unless they are clearly erroneous. *Grove* v. *First National Bank,* 489 F.2d 512, 515 (3d Cir., 1972).

In the instant case the tax court did not treat the blockage issue extensively. Indeed, having accepted the $48.50 value set by the parties in the agreement, the tax court found no need to discuss the application of the blockage rule to the average exchange price of the White stock on the date of the transfer. The tax court did consider blockage, however, in the context of the $48.50 value. Its reluctance to apply blockage to the value of White's stock, though framed in terms of that $48.50 price, in my view, stems from an assessment of the facts relating to this transfer. Based on this factual assessment, the tax court determined that blockage was not applicable in the instant case. I cannot say that this determination was clearly erroneous. That this court's treatment of blockage occurs in the average exchange price context rather than in the $48.50 context does not, in my view, affect the correctness or the applicability of the factual assessments made by the tax court.

The majority, apparently viewing the application of the blockage discount as a question of law, summarily

[1] The majority seems to hold that the applicability of blockage is a question of law which necessarily follows from our holding in Part I of this opinion. In turn, the majority concludes that the amount of blockage is a question of fact. Because White failed to offer any expert testimony, the majority accepts Hess' testimony on this fact.

In my view, both the applicability of and the amount of blockage are factual questions. The applicability of blockage does not necessarily follow from our holding in Part I. The tax court made a factual determination that blockage was inappropriate on the facts of this case. Thus, the issue of the appropriate amount of blockage, which is all that the majority addresses, was not reached by the tax court and should not be reached by us.

rejects the tax court's conclusion on the issue.[2] *See* [91] *supra* at 89. I do not think that blockage follows as a

[2] In my view, the cases cited by the majority do not hold that the applicability of blockage is a question of law. In Commissioner v. Stewart's Estate, 153 F.2d 17 (3d Cir., 1946), decedent Stewart held a block of stock which was valued at the market price on the date of death. Under treasury regulations prevailing at the time, the tax court could and in fact did consider "other relevant *facts* and elements of value." (emphasis added.) 153 F.2d at 19, including a discount for blockage. In affirming, this court held that the tax court "did not err when it found 'fair market value' by *weighing* all *relevant indicia* of what the stocks would bring at market." (emphasis added) 153 F.2d at 19. Determination of what factors are relevant to valuation are peculiarly factual. *Stewart's Estate* in no way holds that blockage is required as a matter of law whenever market price is used to value a block of securities.

Similarly in Richardson v. Commissioner, 151 F.2d 102 (2d Cir., 1945) the Second Circuit affirmed the tax court's determination that a blockage discount was inappropriate. The court stated:

> . . . Surely the Tax Court, if not convinced by the evidence, was not obliged to accept the conclusions expressed by the petitioner's experts. . . . Nor are we at liberty to disturb the ultimate finding merely because an independent appraisal of the evidence might have led us to some different finding of the underlying facts and factors. 151 F.2d at 104 (citations deleted).

Once again the factual nature of the tax court's decision whether or not to apply blockage is evidenced.

In Helvering v. Maytag, 125 F.2d 55 (9th Cir., 1942) the tax court stated "the size of a block of listed stock [is only one] . . . factor to be considered [for] . . . valuation for gift or estate tax purposes." 125 F.2d at 62-63. With this language, the court [91] approved the tax court's application of a blockage discount for estate tax purposes. Once again, however, the conclusion is inescapable that the applicability of blockage in a given case hinges on factual determinations.

matter of law from our ruling that the value of securities be determined from the average price of traded securities on a given day.

Blockage is merely one aspect of the operation of the stock market which adjusts the price of a stock to reflect the information available to the buying community. Where a transfer of shares has not been disclosed to the financial community, a price adjustment is especially appropriate. In the context of an undisclosed transfer, the market price of a security will likely decline with the release of information if only because of the uncertainty caused by a change in the status quo.

A blockage effect is also relevant where a large block of stock is offered on the market at one time. In this context, the excess supply of shares depresses the market price, resulting in an actual decline in market value. By analogy, when a simulation of a block transfer is used to value a security, a blockage discount is appropriate. 10 Mertens, Law of Federal Income Taxation, § 59.15 at 51 (1970).

The cases cited by the majority deal with valuation in which simulated transfers serve as the basis for valuation. In these estate and gift tax cases, the court theorizes about the value of the transferred shares. *See* dissenting opinion, cases cited at n.2 *supra* and cases cited in majority opinion at 83-85. The financial community has received no information about a transfer of shares in the cited cases. As such, the uncertainty of the market's reaction to any large scale transfer has not affected the actual market price of the shares to be valued. A discount is applied when it can reasonably be assumed that if information had been released, the share price would have declined.

In addition, however, valuation in estate and gift tax cases often must be derived from a simulated transfer value since no public transfer is contemplated. If an actual block distribution has in fact taken place, the excess supply of shares would have depressed the market

price. So, too, in the simulation, this blockage discount effect must be considered in valuing the block of shares.

Thus, it seems to me that there are at least two reasons for applying the blockage discount—discounting for uncertainty and discounting for excess supply—both of which are present in the estate and gift tax cases cited by the majority.

In the instant case, however, neither reason for applying the blockage discount is present. The parties to this transfer insured that the financial community was fully informed of this transfer by public announcements[3] and in fact the market price of the White shares declined as this information was digested by the buying community.[4] To [92] apply a blockage rule when the market

[3] A press release containing financial data about the proposed transfer was released on October 6, 1960, at least three weeks before the actual exchange took place on October 31. *See* Appendix at 632.

[4] The White stock declined nine percent between the New York Stock Exchange closing of 40 1/4 on the day of the press release, October 6 and the day of the actual exchange, October 31, when the stock closed at 36 5/8. The decrease in the New York Stock Exchange price paralleled the release of information to the public. By the date of the actual exchange, the financial community had digested this information and the share price began to rise shortly thereafter. Thus, it was possible for the tax court to have found that discounting had already occurred with the release of information on the proposed exchange.

It is interesting to note that the actual pattern of price change of the White stock during the relevant period closely resembles the price activity suggested by Hess' experts as the basis for blockage discount. For example, there was testimony that the simple average price decline (adjusted for market factors) of three large New York Stock Exchange secondary distributions during 1960 was 12.3 percent during the 2-5 weeks between the day before registration and the day of the offering. *See* Appendix at 323-26, 511-19.

already discounted the shares in reaction to the uncertainties involved in such a transfer is to impose a penalty. In effect, the majority has allowed these shares to be doubly discounted, once by the natural operation of market forces and a second time by the court's own action.[5]

In addition the other traditional reason for applying blockage is entirely absent in this case. Since an actual transfer had taken place, there was no need to simulate the effect of a block transfer or to speculate on the effect of dumping an excess number of shares onto the market. An alternate non-market method of transfer was selected so that the simulated blockage effect had no applicability.[6]

In determining that blockage was inappropriate, the tax court, in my view, weighed all of these factors. It is beyond the powers of this court to reassess the facts and to determine that the tax court erred in refusing to apply a blockage discount.

But the majority opinion is incorrect in yet another regard. The majority seems particularly persuaded by White Farm's decision not to present expert testimony on the appropriateness of blockage. *See supra* at 89 n. 46. Although the tax court might properly have drawn

[4] (Continued)

[92] The similarity between the simulated discount suggested by the experts and the actual decrease in share price which occurred with the release of information is in striking support of my view that to apply a blockage discount in this case is to engage in double counting.

[5] *See* n. 4 *supra*.

[6] In Seas Shipping Co., Inc. v. Commissioner, 371 F.2d 528, 530 n. 3 (2d Cir., 1967), the court implied that a blockage discount could have no applicability where an actual non-market rather than a simulated market transfer was utilized for valuation purposes. Although the language in *Seas Shipping* is dicta since the case specifically values the shares by a barter exchange method, I deem the court's logic relevant and persuasive.

APPENDIX B

[189]

WHITE FARM EQUIPMENT COMPANY, A DELAWARE CORPORATION (SUCCESSOR TO OLIVER CORPORATION, A DELAWARE CORPORATION), PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

AMERADA HESS CORPORATION, SUCCESSOR BY MERGER OF HESS OIL AND CHEMICAL CORPORATION, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 4792-69, 5842-70, 1367-71. Filed November 14, 1973.

FORRESTER, *Judge*: Respondent has determined the following income tax deficiencies:

Petitioner	Docket No.	Taxable year	Amount
White Farm Equipment Co.	4792-69	(11/1/60—(12/31/60	$73,300.08
		(1961	9,354,720.80
		(1962	2,587,197.45
Amerada Hess	(5842-70	1964	1,687,232.00
	(1367-71	1965	1,541,601.00

In docket No. 1367-71 petitioner Amerada Hess has claimed an overpayment of income tax in the amount of $2,300,554. The issue for our decision is the valuation of 655,000 shares of White Motor Co. common stock which formed part of the consideration in an exchange in 1960 between predecessors of the petitioners.

FINDINGS OF FACT

Some of the facts are stipulated and are so found.

The original petitioner in docket No. 4792-69 was Oliver Corp. (New Oliver), a Delaware corporation whose prin-

an adverse inference from White's failure to present expert testimony, it is not our function to credit the testimony of Hess' experts when the trier of fact did not. In fact, White Farms did subject Hess' expert to extensive cross-examination on the blockage issue. By categorically accepting the testimony of Hess' expert, the majority has usurped the position of the trier of fact, impliedly asserting that White's cross-examination did not in any way discredit the testimony of Hess' experts. I do not deem it appropriate for a court of appeals to make factual determinations which of necessity require us to hold that cross-examination was ineffective.

For these reasons I must dissent from the majority opinion. I do not feel that the amount of blockage is an issue before this Court. Since the tax court determined blockage inapplicable to the facts of this case, no remand, in my view, is necessary.

cipal offce was in Chicago, Ill., at the time its petition herein was filed. New Oliver's Federal income tax returns for the period from November 1, 1960, to December 31, [190] 1960, and for the taxable years 1961 and 1962 were timely filed using an accrual method of accounting with the district director of internal revenue in Chicago, Ill.

Throughout the period from November 1, 1960, to December 31, 1962, New Oliver was a wholly owned subsidiary of White Motor Corp. (formerly White Motor Co., hereinafter referred to as White Motor). In October 1969 New Oliver was merged into Minneapolis Moline, Inc., also a Delaware corporation, which shortly thereafter changed its name to White Farm Equipment Co. (White). White is the successor to the rights, assets, and liabilities of New Oliver, and is a wholly owned subsidiary of White Motor. At the time White filed an amended petition its principal place of business was in Hopkins, Minn.

Amerada Hess Corp. (Hess), petitioner in docket Nos. 5842-70 and 1367-71, is a Delaware corporation with its principal office in Woodbridge, N.J. Hess is the surviving corporation of a merger on June 20, 1969, between Hess Oil & Chemical Corp. and Amerada Petroleum Corp. Hess Oil & Chemical Corp. timely filed its Federal income tax returns for the taxable years 1964 and 1965 on the accrual method of accounting with the district director of internal revenue in Newark, N.J. Hess Oil & Chemical Corp. was the surviving corporation of a merger on May 23, 1962, between Cletrac Corp. and Hess, Inc., and affiliated companies. Prior to October 31, 1960, Cletrac Corp.'s corporate name had been the Oliver Corp. (Old Oliver).

From 1929 until October 31, 1960, Old Oliver was engaged primarily in the farm equipment business. Beginning in 1944 Old Oliver also manufactured and sold crawler tractors for both argricultural and industrial purposes. It marketed its farm equipment throughout the world and in 1959 its sales volume ranked seventh among all farm equipment manufacturers.

Old Oliver's common stock was listed on the New York Stock Exchange, and throughout the period from 1951 to 1960 it traded at prices substantially below pro rata book value.

For several years prior to 1960 Old Oliver had been actively investigating the possibility of a merger or a substantial sale of assets. Its management was dissatisfied with recent earnings performance, but was convinced that to substantially improve earnings would be a lengthy task. Many of its management practices and policies were being questioned, and the continuity of its management was doubtful because of age. It was also having difficulty in financing the research and development activity necessary to maintain its farm equipment products in a competitive position with its industrial rivals. Because of the recent bankruptcy of another farm equipment manufacturer, lending institutions and the financial markets in general were guarded in their appraisal of the farm equipment industry.

[191] In late 1959 Old Oliver and Studebaker-Packard reached a tentative agreement on a major exchange of assets. However, the proposed exchange did not receive the approval of Studebaker-Packard's board of directors and the negotiations were terminated in January 1960. During 1959 and 1960 Old Oliver also held talks regarding a possible major exchange with representatives of Minneapolis-Moline Co., another manufacturer of farm equipment.

In March 1960 Old Oliver contacted White Motor about a possible sale of all the assets comprising its farm equipment business except cash and accounts receivable. White Motor was primarily engaged in the manufacture, sale, and servicing of large motortrucks. Based on new truck registrations in the United States in 1959, White Motor ranked third in the number of trucks in the classification of 19,501 pounds or more gross vehicle weight. Its principal competitors were Mack Trucks, Inc., General Motors Corp., Ford Motor Co., Chrysler Corp., and International Harvester Co. White Motor also

sold trucks in Canada and 68 other foreign countries. White Motor expressed an interest in acquiring Old Oliver's farm equipment business as a complement to its existing business and the two companies entered serious negotiations.

The principal negotiators were A. L. Mailman (Mailman) for Old Oliver and J. P. Dragin (Dragin) for White Motor. Mailman had considerable experience in negotiations of this type, having represented himself or others in the purchase or sale of assets or businesses on approximately 50 occasions. A number of these transactions involved assets worth $30 to $50 million. He had been a partner in Mailman Brothers, a private investment firm, since 1932, and was a member of Old Oliver's board of directors. In addition he controlled a substantial block of Old Oliver's outstanding stock.

In 1960 Old Oliver had approximately 2,575,000 shares of common stock outstanding. On October 31, 1960, Mailman and his brother, J. L. Mailman, their wives, and companies they controlled held 209,848 shares of such stock. In addition, 114,508 shares were held in trust by other individuals for the benefit of the Mailman family. The 324,356 shares held by or for the Mailman group constituted the largest block of Old Oliver stock held by any one group.

In 1960, Dragin was White Motor's executive vice president for finance and administration and was a certified public accountant. He had previously participated in a number of asset acquisitions by White Motor, and had known Mailman in a business relationship for a number of years.

At their first meetings in March 1960, Mailman informed Dragin that Old Oliver preferred to sell its farm equipment business for cash. [192] It was soon clear, however, that White Motor could not raise nearly enough cash, and that the major part of the consideration would have to be White Motor stock and securities. It was also understood from early on in the negotiations that White

Motor would not acquire Old Oliver's cash, accounts receivable, or liabilities.

At no point during any of their negotiations did Dragin and Mailman ever discuss the value to be placed on White Motor's common stock for accounting or for tax purposes.

Further discussions between Dragin and Mailman took place in April, May, and June. During this period Dragin made a physical examination of the five plants to be purchased from Old Oliver and reviewed pictures, descriptions, and reports prepared by his staff relating to the assets to be purchased. He also engaged Sidney Kriser (Kriser), an expert auctioneer and appraiser of industrial property, to prepare a liquidating appraisal of a large portion of these assets. Kriser visited the plants and submitted a report to Dragin wherein he appraised the liquidating value of the real estate at $2,950,000, and the machinery and equipment at $4,800,000. The book value of these assets at the time of appraisal was $3,519,000 and $7,960,000, respectively.

On June 16, 1960, White Motor's executive committee voted to submit to its board of directors a proposal to purchase the assets comprising the farm equipment business of Old Oliver. An outline of the terms of this proposal was stated in a letter from Dragin to Mailman dated June 17, 1960. The letter contained the following tentative description of how White Motor proposed to pay for Old Oliver's farm equipment business:

> The purchase price is to be an amount equal to the aggregate sum of the book value (after depreciation) of the fixed assets to be sold plus the book value (on the LIFO basis and after deducting the reserve for obsolescence) of the inventory to be sold, less 20% of the aggregate sum of the book value of said fixed assets and of said inventory determined as aforesaid. It is to be understood that the payment of the aforesaid purchase price shall entitle The White Motor Company to the exclusive use

of the names "The Oliver Corporation" and "Oliver International S. A." • • • The purchase price is to be paid (a) by the delivery of five hundred thousand (500,000) shares of Common Stock of The White Motor Company, to be considered as having a value of Twenty-five Million Dollars ($25,000,000), and (b) the balance of the purchase price is to be paid in cash or in debentures at par • • •

• • •

The closing of the transaction is to take place on October 31, 1960, or as soon thereafter as practicable • • •

• • •

The White Motor Company has to arrange financing satisfactory to its Board of Directors before some of the provisions of the contemplated contract can be agreed upon. • • •

[193] This proposal was approved by White Motor's board of directors on June 22, 1960, with the following resolution:

> Resolved, That the terms of the proposed transaction between the White Motor Company and the Oliver Corporation stated in Mr. Dragin's letter of June 17, 1960 to Mr. A. L. Mailman, subject to the other terms and provisions of a contract between the two companies being worked out to the satisfaction of both companies and subject also to The White Motor Company's being able to make financial arrangements satisfactory to the Board of Directors, be and hereby is approved, and that the officers of the Company be and hereby are authorized to proceed to attempt to make such satisfactory financial arrangements.

Old Oliver's board of directors considered the proposal set forth in Dragin's June 17 letter at a special meeting on June 23, 1960. The following resolution was adopted after the proposal was discussed:

> Resolved that Alva W. Phelps and A. L. Mailman be, and they hereby are, authorized to continue negotiations with The White Motor Company for the sale of certain assets of the Company to The White Motor Company on the basis of the letter dated June 17, 1960, from J.P. Dragin, Executive Vice President of The White Motor Company, to A. L. Mailman, except that instead of a portion of the purchase price being paid by 500,000 shares of The White Motor Company common stock valued at $50 per share, a portion shall be paid by one share of The White Motor Company's common stock for each five shares of The Oliver Corporation's outstanding common stock (including that under option), which payment shall be valued on the basis of the closing market price of The White Motor Company stock on June 23, 1960.

White Motor's common stock closed at $48.50 on the New York Stock Exchange on June 23, 1960.

During June and July of 1960, Dragin sought to arrange the financing which White Motor needed in order to execute its part of the proposed exchange. In addition to the potentially large sum of cash which was called for by the June 17 proposal, White Motor also needed to raise $20 million in working capital because it was not acquiring Old Oliver's cash or accounts receivable. Dragin encountered great difficulties in arranging the requisite financing.

On August 1, 1960, White Motor's board of directors decided that the company should not enter into the proposed exchange with Old Oliver unless satisfactory financing could be arranged. Further negotiations were held during August and a number of alternatives were proposed to lessen White Motor's financing difficulties. The upshot of these discussions was an agreement (1) to increase to 655,000 the number of shares of common stock which White Motor would transfer to Old Oliver and (2) to decrease the amount of cash which White Motor might have to pay to adjust for Old Oliver's closing

inventories. The assigned value of $48.50 per share of White Motor common stock was retained.

On September 22, 1960, Dragin informed the board of directors of White Motor that arrangements to provide the necessary financing [194] were nearly completed. Such arrangements were subsequently approved by the board of directors on September 30, 1960, and a formal loan agreement was later executed on October 4, 1960, under which White Motor borrowed $20 million from a group of insurance companies.

In September 1960, White Motor's board of directors resolved to hold a special shareholder meeting on October 31, 1960, for the purpose of considering and acting on the proposed acquisition of the Oliver farm equipment business. A draft of the proxy statement to be sent to White Motor's shareholders prior to the October 31 meeting was prepared in early September and routinely submitted to the United States Securities and Exchange Commission for its comments. The draft of the proxy statement included a pro forma balance sheet projecting White Motor's financial position after the proposed acquisition of Old Oliver's farm equipment business. The assets to be acquired from Old Oliver were recorded on the pro forma balance sheet at a cost which was based on their net book value but which was then adjusted downward by a total of more than $10 million. This downward adjustment was explained by the following footnote:

> (2) These amounts represent the excess of Oliver book value over White acquisition cost. The amount of excess will be adjusted for the difference between the assigned value of $48.50 per share of White common stock and its market value on the closing date.

The pro forma balance sheet also contained the following footnote explaining the entry in the capital stock account:

> (3) Issuance of 655,000 shares of common stock at an assigned value of $48.50 per share, or an aggregate of $31,767,500, of which the sum of $1.00 per share is credited to the common stock account and the sum of $47.50 per share is credited to capital in excess of par value of capital stock. The aggregate credit to capital in excess of par value of capital stock of $31,112,500 is subject to a decrease or an increase in the same amount as the adjustment to the excess referred to in Note C (2) above.

The pro forma balance sheet in the draft of the proxy statement also reflected the financing arrangements which had been made to provide White Motor the working capital it would need to conduct the Oliver farm equipment business. A footnote to the cash and notes payable accounts also predicted that the cash payment to Old Oliver would decrease as follows:

> (1) Issuance of long-term notes payable to insurance companies amounting to $20,000,000 and cash payment of $9,045,000 to Oliver. If the inventories decrease between July 31, 1960 and October 31, 1960 • • • the cash payment required to be made by White to Oliver will decrease by 80% of such decrease in the book value of the inventories. Based on the decrease in inventories during the period from July 31, 1959 to October 31, 1959 it is estimated that the cash payment will be decreased by $3,760,000.

[195] A copy of this pro forma balance sheet together with the footnotes was reviewed by Dragin and other top White Motor officials before it was submitted to the SEC. These footnotes appeared again in identical form in the final proxy statements which were distributed to White Motor's shareholders on October 10, 1960.

On September 30, 1960, the SEC responded to White Motor's preliminary proxy in a letter which included the following comment:

> Paragraph (a) on page 3 should specifically state whether any adjustment will be made at the closing date to reflect changes in the market price of White's

stock in determining the value of the 655,000 shares to be issued. The closing date should be given, and if as it appears, no adjustment for changes in the market price is to be made, it should be stated that the 655,000 shares are being issued on the basis of $48.50 per share whereas the market price on ..... (latest practicable date) was $..... per share.

The following language was included in the final proxy statement sent to White Motor's shareholders, but was not included in the draft of the proxy statement prepared in September:

> No adjustment in the number of shares of the White Company Common Stock to be issued as hereinabove provided will be made on account of changes in the market price of Common Stock of the White Company. (The 655,000 shares of Common Stock of the White Company to be issued as hereinabove provided are to be issued on the basis of $48.50 per share, whereas the last sale on the New York Stock Exchange on October 3, 1960, was at the price of $42.375 per share.)

White Motor's proxy statements described the factors giving rise to the purchase price of the assets acquired by White Motor and the value of the White stock to be exchanged, as follows:

> The provisions of the proposed contract between The Oliver Corporation and the White Company were determined by arms [sic] length bargaining between the officers and representatives of the two corporations. Factors which were considered in the negotiations and which resulted in the determination of the purchase price of the property and assets of The Oliver Corporation to be purchased by the White Company were the earnings records of the White Company and of The Oliver Corporation's farm equipment business, the values of the properties

> and assets to be purchased by the White Company, the value of the Common Stock of the White Company, the respective prices at which the Common Stocks of the two corporations have been selling over a period of five years last past, and the prospects and potentialities of the farm equipment business and of the other businesses of The Oliver Corporation, and of the businesses of the White Company.

The proxy statement sent to the shareholders was accompanied by a letter from White Motor's president recommending that the shareholders approve the proposed agreement with Old Oliver and including the following passage:

> Under the terms of the contract and based on July 31, 1960 figures, The White Motor Company would acquire inventories, fixed assets and certain other assets [196] having a book value on the books of The Oliver Corporation (after deduction of a LIFO reserve on inventories in the sum of $7,733,000) of $51,410,000. In payment for these assets, The White Motor Company would issue 655,000 shares of its Common Stock, which had a market value on October 3, 1960, of $42.375 per share, or an aggregate of approximately $27,750,000, and make a cash payment estimated not to exceeed aproximately $9,000,000. • • •

Dragin reviewed both the final proxy statement and the letter to the shareholders.

In a press release dated October 6, 1960, White Motor announced its proposed agreement with Old Oliver and made the following statements:

> Under the terms of the contract and based on July 31, 1960 figures, The White Motor Company would acquire inventories, fixed assets and certain other assets having a book value on the books of The Oliver Corporation (after deduction of a LIFO reserve on inventories in the sum of $7,733,000) of $51,410,000. In payment for these assets, The White Motor Com-

pany would issue 655,000 shares of its common stock, which had a market value on October 3, 1960, of approximately $27,750,000, and make a cash payment estimated not to exceed $9,000,000.

At a meeting in early October 1960, Old Oliver's board of directors authorized its officers to execute the proposed agreement to sell its farm equipment business to White Motor, subject to a vote of approval from its shareholders at a special meeting called for October 31. Pursuant to a requirement in the proposed agreement, the board further resolved to change the name of Old Oliver to Cletrac Corp., also subject to a shareholder vote.

The proxy statements which Old Oliver sent to its shareholders prior to the October 31 meeting included the following language in respect of the value to be placed on the block of White Motor common stock:

> The price for the inventories, fixed assets and prepaid items will be paid first, in 655,000 shares of common stock of White, which for this purpose are taken at $48.50 per share, or an aggregate of $31,767,-500. Fluctuations in the market value of White common stock prior to the Closing Date will not change the agreed valuation of $48.50 per share. At September 26, 1960, the closing market price of White common stock was $41 per share and the aggregate value of 655,000 shares was $26,855,000, which was $4,912,500 less than the assigned value. • • •
>
> • • •
>
> Oliver is informed by its attorneys that the sale of assets to White is a taxable transaction to Oliver, and that gain or loss will result to Oliver in the amount of the difference between the cash plus the value of the White stock received and the income tax basis of the property sold. • • •
>
> • • •

> A decline in the value of the White common stock prior to the Closing Date will increase the loss on the sale. This increase in loss would amount to $4,912,500 if that value were the closing market price of White common stock on September [197] 26, 1960. In addition, as indicated on page 4, the Closing Date may be a date later than October 31, 1960. Oliver makes no representation as to what the market value of White common stock will be at the Closing Date.

Also included in this proxy statement was the following passage:

> The Agreement with White requires Oliver to dispose of the common stock of White received by Oliver, and until it is disposed of, such stock will be held by The Cleveland Trust Company in trust under the terms of the Trust Agreement attached hereto as an exhibit.
>
> Oliver is applying to the Internal Revenue Service for a ruling to the effect that if Oliver distributes pro rata to its stockholders the 655,000 shares of stock of White, the receipt of common stock of White by the Oliver stockholders will be taxable as a capital gain or loss as if each Oliver stockholder had sold a portion of his Oliver stock, and that the distribution will not be taxable as an ordinary dividend. If a favorable ruling is obtained, the common stock of White will be distributed pro rata to the Oliver stockholders in exchange for a portion of the common stock of Oliver. The Agreement provides that if a favorable tax ruling is received, Oliver will so distribute the common stock of White within two months of receipt of the ruling or seven months after the Closing Date, whichever is later. The method of disposition of the White common stock may require approval by the stockholders of Oliver.
>
> If a favorable ruling is not received, some other method of disposal of the White stock will have to be adopted. The Trust Agreement provides that

> Oliver may cause the common stock of White to be distributed pro rata to its stockholders or sold in transactions where no more than 10,000 shares of common stock of White is sold to any one person. • • •

In a press release dated October 6, 1960, Old Oliver made the following statements in respect of the proposed exchange with White Motor:

> Under the terms of the agreement and based on July 31, 1960 figures, White would acquire inventory, fixed assets and certain other assets having a book value on the books of Oliver (after a deduction of a LIFO reserve on inventory in the amount of $7,733,000) of approximately $51,410,000. In payment for these assets, White would issue to Oliver 655,000 shares of its common stock which had a market value on October 3, 1960 of $27,750,000 and make a cash payment estimated at not to exceed $9,000,000. The cash payment will depend on changes in inventory levels of Oliver between July 31, 1960 and the closing date, which is expected to be October 31, 1960. If the inventories of the farm equipment business of Oliver declined between July 31, 1960 and October 31, 1960 by the same amount as they did during the same period during 1959, the estimated cash payment of $9,000,000 would be reduced by approximately $3,760,000.
>
> • • •
>
> Oliver will distribute the White common stock to Oliver's shareholders on a pro rata basis, in exchange for a portion of the common stock of Oliver, subject to receipt of a ruling from the Internal Revenue Service that such a distribution will not be taxable as a dividend. If a favorable tax ruling is received, Oliver will distribute the common stock of White within two months of receipt of the ruling or seven months after the closing date, whichever is later.
>
> Oliver will change its name to Cletrac Corporation.

On October 3, 1960, the officers of Old Oliver and White Motor formally executed a written agreement (agreement) defining the terms [198] of the proposed sale of the Oliver farm equipment business to White Motor, subject to the approval of the shareholders of both corporations. The requirement of shareholder approval was expressed in the agreement as follows:

> 38. The obligations of the parties hereto to carry out this Agreement are subject to the express condition that the holders of at least a majority of the outstanding shares of the capital stock of the Oliver Corporation shall • • • have voted in favor of the proposal • • • and to the express condition that the shareholders of the White Company • • • shall have approved this Agreement by a majority of the votes cast on the proposal • • • and that the total vote cast on the proposal represents over fifty per cent (50%) of the combined voting power of the Preferred Stock and Common Stock of the White Company • • •

At their respective meetings on October 31, 1960, the shareholders of Old Oliver and White Motor approved the agreement.

The assets comprising the farm equipment business to be transferred from Old Oliver to White Motor were enumerated in paragraph 6 of the agreement, which provided, in pertinent part, as follows:

> 6. Subject to the conditions herein set forth, The Oliver Corporation agrees to sell and transfer to the White Company, and the White Company agrees to purchase from The Oliver Corporation, all of the following described properties and assets of The Oliver Corporation as of the close of business on the Closing Date, to wit:
>
> (a) All of the inventories (including raw materials in process of manufacture, finished products, spare parts and supplies) owned by The Oliver Cor-

poration and held for sale or use in connection with its farm equipment business • • •

(b) All land and appurtenances thereto, buildings, building fixtures and tangible personal property other than inventories, owned or used by The Oliver Corporation in connection with its farm equipment business • • • and all machinery, equipment, jigs, dies, production fixtures, other tools, patterns, drawings, vehicles, and furniture located at said plants or used in connection with its farm equipment business.

(c) All branch real estate • • • which is held or used by The Oliver Corporation in connection with its farm equipment business, and all machinery, equipment, jigs, dies, production fixtures, other tools, patterns, drawings, vehicles, and furniture located at The Oliver Corporation's branches, which are held or used by The Oliver Corporation in connection with its farm equipment business, and all furniture and equipment at the home office of The Oliver Corporation.

(d) All books and records of The Oliver Corporation relating to its farm equipment business • • •

(e) All patents, applications for patents, inventions, discoveries, assignable patent licenses, contracts for the payment of royalties to The Oliver Corporation, copyrights, trademarks and trade names owned by The Oliver Corporation and pertaining to or useful in or in connection with its farm equipment business • • •

(f) All good will connected with the farm equipment business of The Oliver Corporation, including, but not limited to, all rights possessed by The Oliver Corporation in and to the name "Oliver."

(g) All of the right, title and interest of The Oliver Corporation in and to contracts made or orders given by The Oliver Corporation in the usual and normal course of business for the purchase by The Oliver Corporation of [199] materials, parts and factory supplies for use in the manufacture, sale or servicing of farm equipment.

(h) All of the right, title and interest of The Oliver Corporation in and to contracts made or orders received by The Oliver Corporation in the usual and normal course of business for servicing, not completed at the close of business on the Closing Date, of farm equipment, and for the sale by The Oliver Corporation and delivery after the close of business on the Closing Date of farm equipment • • • and in and to deposits of money or other property made by customers on the contracts or orders hereinabove in this subparagraph (h) described, or any of them.

(i) All of the right, title and interest of The Oliver Corporation in and to the leases of real estate listed in Exhibit E, hereunto attached and made a part hereof, provided that The Oliver Corporation obtains the consent of the respective Lessors where necessary.

(j) The following prepaid items and supplies to the extent that they relate to the assets to be purchased by the White Company under the foregoing subparagraphs (a), (b), (c), (d), (e), (f), (g), (h), and (i) of this paragraph 6:

Merchandising Items
Stationery and Office Supplies
Repair Parts Catalogues
Prepaid Insurance to the extent the insurance is transferable
Costs for Production Tooling
Uncompleted Fixed Assets
Freight and Express Clearings (Collectible Claims)
Postage Stamps and Deposits
Other Prepaid Factory Expenses
Other Prepaid Branch Expenses
Other Prepaid Executive Office Expenses

Except as otherwise provided in options to be granted to the White Company as in this Agreement provided, it is understood and agreed that the properties and assets to be sold to the White Company under

this Agreement shall not include any cash, securities or notes or accounts receivable owned by The Oliver Corporation • • • nor its crawler tractor business, as defined in the Option Agreement, a copy of which, marked Exhibit F, is hereunto attached and made a part of this Agreement • • • nor any property or asset not described in subparagraphs (a), (b), (c), (d), (e), (f), (g), (h), (i), and (j) of this paragraph 6 or in paragraphs 11, 12 and 21 of this Agreement. The phrase "farm equipment business," as used in this Agreement, means the manufacture and sale of products of the type produced in The Oliver Corporation's Battle Creek, Michigan, #1 plant, its Charles City, Iowa, plant, its Shelbyville, Illinois, plant and its South Bend, Indiana, #1 plant, and does not include the manufacture or sale of crawler tractors and allied equipment.

The price which White Motor was required to pay for the farm equipment assets was to be computed in accordance with paragraph 7, which provided, in pertinent part, as follows:

> 7. Subject to the conditions in this Agreement set forth, the White Company agrees to pay to The Oliver Corporation for all of the properties and assets hereinabove described in subparagraphs (a), (b), (c), (d), (e), (f), (g), (h), and (i) of paragraph 6 of this Agreement, a sum which is equal to the sum of fifty per cent (50%) of the book value, at the close of business on the Closing Date, of the closed South Bend Foundry, plus eighty per cent (80%) of the book value, at the close of business on the Closing Date, of the inventories and, except the closed South Bend Foundry, of the land, land improvements, [200] buildings and improvements, railroad sidings, machinery and equipment, furniture and fixtures, dies, jigs, fixtures, material handling equipment, patterns, flasks, automobiles, trucks, tractors

and other additions in process, purchased by the White Company from The Oliver Corporation under the provisions of this Agreement. • • •

Subject to the conditions in this Agreement set forth, the White Company shall pay the following prices for the prepaid items and supplies described in subparagraph (j) of said paragraph 6, except that the White Company shall not pay any amount for any prepaid item which is applicable to periods of time prior to the close of business on the Closing Date:

Stationery and Office Supplies and Repair Parts Catalogues: fifty per cent (50%) of book value of the inventory at the close of business on the Closing Date;

Freight and Express Clearings (Collectible Claims), Postage Stamps and Deposits, Merchandising Items and Prepaid Insurance: one hundred per cent (100%) of book value at the close of business on the Closing Date;

Costs for Production Tooling, Uncompleted Fixed Assets, Other Prepaid Factory Expenses, Other Prepaid Branch Expenses, Other Prepaid Executive Office Expenses, as follows: one hundred per cent (100%) of book value at the close of business on the Closing Date, if chargeable to customers or vendors, eighty percent (80%) of such book value if the items are to be capitalized, and one hundred per cent (100%) of book value if the items are cash items.

The White Company shall purchase such prepaid items and supplies only to the extent that they relate to the farm equipment business • • •

Paragraph 8 set forth the method by which White Motor would pay the purchase price and provided, in pertinent part, as follows:

> 8. The purchase price hereinabove provided for in paragraph 7 shall be paid as follows: The sum

of Thirty-one Million Seven Hundred Sixty-seven Thousand Five Hundred Dollars ($31,767,500) shall be paid by the White Company by the delivery, on the Closing Date, to The Cleveland Trust Company, of Cleveland, Ohio, of certificates for six hundred fifty-five thousand (655,000) shares of the Common Stock of the White Company, made out and registered in the name of said The Cleveland Trust Company, or its nominee, to be held and disposed of by said Trust Company as provided in the Trust Agreement, a copy of which, marked "Exhibit G," is hereunto attached and made a part hereof, and The Oliver Corporation and the White Company each agrees on said Closing Date duly to execute said Trust Agreement. As soon as practicable after the Closing Date, the purchase price of the properties and assets described in subparagraphs (a), (b), (c), (d), (e), (f), (g), (h), (i), and (j) of paragraph 6 of this Agreement, at the close of business on the Closing Date, shall be computed in the manner hereinabove in paragraph 7 provided, and thereupon the White Company shall forthwith pay to The Oliver Corporation the unpaid balance, if any, of said purchase price, as so computed, by check payable to the order of The Oliver Corporation. If the said computation shall show that the purchase price is less than Thirty-one Million Seven Hundred Sixty-seven Thousand Five Hundred Dollars ($31,767,500), The Oliver Corporation shall forthwith pay to the White Company by The Oliver Corporation's check the difference between the said purchase price and the said sum of Thirty-one Million Seven Hundred Sixty-seven Thousand Five Hundred Dollars ($31,767,500). If the determination of the said purchase price has not been made by the Seventy-fifth day after the Closing Date, then a payment shall be made on the Eightieth day after the Closing Date, by the White Company or The Oliver Corporation, as the case may be, based on all amounts not in dispute and the payment of

any disputed amounts [201] thereafter determined to be due shall be made forthwith upon the resolution of the disputes.

The agreement also provided that White Motor would purchase Old Oliver's interest in two foreign subsidiaries, Oliver International, S.A., and the Oliver Corp., Argentina, S.A. The relevant language read as follows:

> 11. The Oliver Corporation agrees to sell and transfer to the White Company on the Closing Date all of the outstanding capital stock of Oliver International, S.A., and the White Company agrees to pay therefor as provided in this paragraph 11. The White Company will pay to The Oliver Corporation a sum equal to eighty per cent (80%) of the book value (after depreciation) at the close of business on the Closing Date of the machinery, equipment, jigs, dies, production fixtures, other tools, patterns and furniture, owned by Oliver International, S.A.
> • • •
>
> 12. The White Company agrees to purchase from The Oliver Corporation, and The Oliver Corporation agrees to sell to the White Company, all of the outstanding capital stock of The Oliver Corporation, Argentina, S.A. for a price equal to the cash held by said The Oliver Corporation, Argentina, S.A. at the close of business on the Closing Date, and uncollected royalties receivable from La Cantabrica, S.A. an Argentine corporation, with respect to sales made prior to the close of business on the Closing Date less the obligations of The Oliver Corporation, Argentina, S.A., at the close of business on the Closing Date.
> • • •

Old Oliver agreed to change its corporate name in the following provision:

> 24. The Oliver Corporation agrees to consent, on the Closing Date, to the use of the name "The Oliver

Corporation," or any name including the word "Oliver," by the White Company or any subsidiary thereof, and promptly to change its own name to a name not containing the word "Oliver." • • •

The agreement expressly stated that it represented the entire agreement between the parties:

50. This Agreement contains the entire Agreement between the parties hereto with respect to the transactions herein contemplated, and supersedes all prior agreements or understandings between the parties hereto relating to the subject matter hereof. This Agreement is not made for the benefit of any person except the parties to this Agreement.

The block of 655,000 shares of common stock transferred pursuant to the agreement represented approximately 24 percent of the White Motor common stock outstanding after the exchange with Old Oliver was completed. Except for this block of shares, no shareholder or affiliated group of shareholders of White Motor owned as much as 10 percent of its voting stock. Although Old Oliver intended to distribute the White Motor common stock to its shareholders if favorable tax treatment could be assured, White Motor was still concerned about concentrating so many shares of its voting stock in one block. This concern caused White Motor to insist that the block of shares be delivered directly to a trust rather than to Old Oliver, and that the trust agreement be written to ensure a wide distribution of the stock. The [202] trust agreement which resulted from these demands included the following provisions:

WHEREAS, Oliver and White desire to create this Trust for the purpose of assuring that said shares of Common Stock of White (together with all additional shares of Common Stock of White, if any, which may be declared and paid as a dividend there-

on) shall be either distributed to the shareholders of Oliver as hereinafter provided or sold in a public offering as hereinafter provided; and

• • •

Upon written request of Oliver, the Trustee shall make available from time to time to Oliver all or any part of the shares of Common Stock of White hereinbefore referred to then held by the Trustee under this Agreement for either or both of the following purposes, but only for the following purposes, to wit:

(a) For distribution to Oliver's stockholders in proportion to their respective holdings of Common Stock of Oliver • • •

• • •

(b) For sale in a public offering under which the Trustee shall make delivery thereof to underwriters at the principal office of the Trustee, upon the written instruction of Oliver acknowledging receipt from the underwriters of the consideration to be paid by the underwriters therefor, subject to fulfillment of the following conditions, namely:

(i) Receipt by the Trustee at the time of such delivery of an executed copy of an underwriting agreement between Oliver and the underwriters, covering the shares of Common Stock of White to be delivered, which underwriting agreement shall contain a covenant on the part of the underwriters, reading substantially as follows:

"The Underwriters agree that if, during the distribution of said Common Stock, any Underwriter receives an order for more than 10,000 shares from any purchaser such Underwriter will notify the Representative of the Underwriters and the Representative will notify The White Motor Company of the receipt of such order and such Underwriter will not, without the approval of The White Motor Company, fill such order in excess of 10,000 shares."

• • •

In case Oliver, within 32 months after the date of this Agreement, shall not have disposed of, as in this Agreement provided, all of the Common Stock of White held by the Trustee hereunder, White, at any time thereafter, may serve written notice on Oliver that White desires to have all of the said stock disposed of either by distribution to the stockholders of Oliver as hereinbefore provided, or by sale in a public offering as hereinbefore provided. • • • Oliver shall be deemed to have authorized White to make such disposition as Oliver's agent. • • •

• • •

The Trustee, during the life of the Trust in this Trust Agreement set forth, shall have power and authority to collect and receive all dividends payable on the said Common Stock of White held by it, and promptly upon receipt thereof, shall remit said dividends to Oliver, provided, however, that any stock of White received by the Trustee by virtue of its record ownership of the Common Stock of White held by it hereunder shall be held and disposed of in the same manner as in this Trust Agreement provided with respect to the Common Stock originally deposited hereunder. • • •

The trust agreement also provided an elaborate arrangement designed to ensure that during the term of the trust the trustee would vote the block of White Motor shares according to the instructions of Old [203] Oliver's shareholders rather than its board of directors. Concern about the size of the block of common stock also prompted White Motor to require inclusion of the following provision in the agreement itself:

> 39. The Oliver Corporation agrees, promptly after the execution of this Agreement, to prepare and file with the Internal Revenue Service a request for a ruling that distribution of the Common Stock of the White Company to be issued to The Cleveland Trust

> Company under the provisions of this Agreement, pro rata to the stockholders of The Oliver Corporation (but subject to adjustment by cash or scrip for fractional shares), will qualify as a partial liquidation of The Oliver Corporation and that the stockholders of The Oliver Corporation, upon their receipt of their respective shares of such stock of the White Company, will not be deemed to have realized distributions taxable as ordinary income. The Oliver Corporation agrees to use its best efforts to obtain such a ruling, and in the event such a ruling is received, The Oliver Corporation agrees to take all steps necessary to be taken by it to cause such distribution to its stockholders within two (2) months after receipt of such ruling, or seven (7) months after the delivery of such stock of the White Company to The Cleveland Trust Company, whichever is later.

Old Oliver and White Motor closed the agreement on October 31, 1960, after a vote of approval by the shareholders of both corporations. At the closing Old Oliver transferred the assets specified in the agreement to White Motor. Old Oliver's final book values for such assets were as follows:

I. Inventory:			
On first-in first-out method		$31,745,068	
Less:			
Accumulated adjustments to inventory to elective method (LIFO)	$7,301,850		
Reserve for inventory adjustment	665,398	7,967,248	
Net inventories			$23,777,820
II. Fixed assets:			
A. Real estate and improvements:			
Plants	3,698,551		
Branches	2,861,343		
Total real estate and improvements		6,559,894	
B. Machinery and equipment:			
Plants	7,755,727		
Branches	479,462		
Total machinery and equipment		8,235,189	
C. Tooling:			
Plants	3,905,740		
Branches	0		
Total tooling		3,905,740	
Total fixed assets			18,700,823
Prepaid items			427,120
Total			42,905,763

[204] Also on October 31, 1960, White Motor delivered 655,000 shares of its common stock to the trustee in accordance with the trust provisions of the agreement. In addition, White Motor paid Old Oliver $1,508,550 in cash and assumed $281,396 in liabilities on the farm equipment assets transferred to it.

On November 1, 1960, White Motor transferred the Oliver farm equipment business which it had received under the agreement to New Oliver in exchange for New Oliver's common stock. New Oliver's tax basis in the farm equipment business on November 1, 1960, was the same as White Motor's tax basis.

Both White Motor and New Oliver initially recorded the acquisition of Old Oliver's farm equipment business at a total cost of $23,784,687.50 on their books of account. This cost was derived by valuing the 655,000 shares of White Motor common stock at $36.3125 per share, the average price of White Motor common stock on the New York Stock Exchange on October 31, 1960.

White Motor's initial entries were reversed sometime in January 1961, before the books were closed for the calendar year 1960, and the final entries recorded the farm equipment business at a cost reflecting a value of $48.50 for each share of White Motor common stock. The initial entries were changed at the suggestion of White Motor's tax department and its independent certified public accountants. The following language is from a memorandum dated January 4, 1961, in the files of White Motor's accountants:

> In Note C (2) of notes to the pro forma consolidated balance sheet included in The White Motor policy [sic (proxy)] statement of October 10, 1960, White stated that the stock issued in the acquisition would be recorded at market value on the closing date. The question was raised as to SEC's position as White records the stock at $48.50. * * * there should be no problem, and if a question is raised White could state that at the time of the policy [sic (proxy)] statement the values had not been determined, and that on advice of consul [sic] a statement was included in the proxy statement that the adjustment would be made to the market value. Subsequent to the date of the proxy statement consul [sic] has

advised White that the $48.50 value per share is proper for both accounting and tax purposes.

New Oliver prepared its Federal income tax returns for 1960, 1961, and 1962, on the basis that the assets received under the agreement had been acquired in exchange for White Motor common stock having a value of $48.50 per share.

Old Oliver recorded the block of White Motor common stock on its books at a total value of $23,784,688, or $36.3125 per share. It also valued the stock at $23,784,688 in reporting a loss on the sale of its farm equipment business in its Federal income tax return for 1960.

On December 9, 1960, and again on March 23, 1961, Old Oliver requested a ruling from the Internal Revenue Service with respect to the [205] distribution of its 655,000 shares of White Motor common stock to its shareholders, and received favorable rulings. Pursuant to a plan of partial liquidation adopted by its shareholders on June 30, 1961, approximately 653,770 shares of the block of 655,000 shares were either distributed directly to the Old Oliver shareholders or sold on the market and the proceeds made available to the shareholders. The remainder of approximately 1,230 shares of White Motor common stock not so distributed or sold was held by Old Oliver as an investment.

White Motor common stock had been listed on the New York Stock Exchange for many years prior to October 31, 1960. On October 31, 1960, immediately prior to the issuance of the block of 655,000 shares of White Motor common stock, White Motor had outstanding 2,112,157 shares of common stock and 55,108 shares of $100 par value preferred stock. During the years 1959, 1960, and 1961, the number of White Motor common shares traded on the New York Stock Exchange totaled 472,500, 444,000, and 622,600, respectively. The trading volume in White Motor common stock on the New York Stock Exchange over the first 10 months of 1960 was reported as follows:

Month	*Volume of shares traded*	*Month*	*Volume of shares traded*
January	25,500	June	48,800
February	31,900	July	26,200
March	46,900	August	25,200
April	30,900	September	31,100
May	36,000	October	34,100

The average monthly trading volume over this period was approximately 33,650. On October 31, 1960, 3,300 shares of White Motor common stock were traded on the New York Stock Exchange.

On October 31, 1960, the price of White Motor common stock on the New York Stock Exchange was at the lowest point it reached at any time during the 3 years 1959, 1960, and 1961. The monthly trading highs and lows of White Motor's common stock on the New York Stock Exchange during these 3 years were as follows:

	1959		1960		1961	
Month	High[1]	Low[1]	High	Low	High	Low
January	37.14	32.14	67.750	58.250	50.875	40.250
February	40.60	33.93	62.500	53.500	55.750	47.500
March	40.95	38.10	62.250	50.750	53.750	51.250
April	48.33	38.81	55.250	46.500	57.750	52.750
May	49.76	42.14	50.000	45.000	59.750	52.750
June	55.48	48.09	52.000	46.250	60.500	55.250
July	57.14	53.33	47.500	41.500	57.500	51.750
August	55.71	49.05	47.750	43.375	57.500	52.500
September	55.00	46.67	45.000	39.625	53.125	48.500
October	57.26	51.90	42.625	36.000	52.500	45.500
November	59.76	56.43	39.750	36.750	51.875	45.500
December	66.75	60.50	43.000	37.000	54.625	50.625

[1] Adjusted to reflect 100-percent stock split in March 1959 and 5-percent stock dividend in January 1960.

[206] The low price of White Motor common stock during October 1960 was due in part to an overall decline in the stock market. Factors causing the decline in the market were the poor performance of the national economy during the third quarter of 1960, and the uncertainty about the outcome of the upcoming presidential elections in November 1960.

OPINION

On October 31, 1960, White Motor purchased the farm equipment business of Old Oliver (including the Oliver trade name) in exchange for 655,000 shares of White Motor common stock (White stock), $1,508,550 in cash, and the assumption of $281,396 in liabilities. Old Oliver immediately changed its corporate name to Cletrac Corp., and on November 1, 1960, White Motor transferred the Oliver farm equipment business to its wholly owned subsidiary, New Oliver, in a non-taxable exchange. Petitioner White Farm Equipment Co. (White) is the successor-in-interest to White Motor and New Oliver, and petitioner Amerada Hess Corp. (Hess) is the successor-in-interest to Old Oliver.

We are asked to decide the value to be placed on the block of 655,000 shares of White stock for the purposes of (1) determining the extent of Old Oliver's original loss and Hess' carryover loss from the sale of the farm equipment business and (2) determining White's tax basis in the farm equipment business. Old Oliver's loss on the sale of its farm equipment business is measured by the excess of its adjusted basis over the sum of the money received plus the fair market value of other property (essentially the shares of White stock) received. Sec. 1001 (a) and (b)[1] White's basis in the farm equipment business is the cost of such property, cost being the amount paid for such property in cash or other property. Sec. 1012;

[1] All statutory references are to the Internal Revenue Code of 1954, unless otherwise specified.

sec. 1.1012-1(a), Income Tax Regs. Since "the amount paid" by White included "other property" (the shares of White stock) it is necessary to determine the value in dollars of that stock.

Hess has argued for a valuation of approximately $20 million (slightly more than $30 per share) in order to maximize its carryover loss, and White has argued for a valuation of $31,767,500 ($48.50 per share) in order to maximize its tax basis. Respondent is essentially a stakeholder in this case and his primary concern is that we deal consistently with both petitioners. On brief, however, respondent has supported the arguments made by Hess.

We hold that the value to be placed on the block of White shares is, as petitioner White has argued and as set forth by the parties in their agreement, $31,767,500 ($48.50 per share).

[207] The agreement between White Motor and Old Oliver expressly stated that it represented the entire agreement between the parties as follows:

> This Agreement contains the entire Agreement between the parties hereto with respect to the transactions herein contemplated, and supersedes all prior agreements or understandings between the parties hereto relating to the subject matter hereof. • • •

Payment of the assets purchased by White Motor was provided for in the agreement in pertinent part as follows:

> 7. • • • the White Company agrees to pay to The Oliver Corporation for all of the properties and assets hereinabove described • • • *a sum which is equal to the sum* of [the various percentages of book value of the assets to be acquired] • • •
>
> • • •
>
> 8. The purchase price hereinabove provided for in paragraph 7 shall be paid as follows: *The sum of Thirty-one Million Seven Hundred Sixty-seven Thou-*

sand Five Hundred Dollars ($31,767,500) shall be paid by the White Company by the delivery, on the Closing Date • • • of certificates for six hundred fifty-five thousand (655,000) shares of the Common Stock of the White Company • • •. As soon as practicable after the Closing Date, the purchase price of the properties and assets • • • shall be computed • • • and thereupon the White Company shall forthwith pay to The Oliver Corporation the unpaid balance, if any, of said purchase price, as so computed • • •. If the said computation shall show that the purchase price is less than Thirty-one Million Seven Hundred Sixty-seven Thousand Five Hundred Dollars ($31,767,500), The Oliver Corporation shall forthwith pay to the White Company by the Oliver Corporation's check the difference between the said purchase price and the said sum of Thirty-one Million Seven Hundred Sixty-seven Thousand Five Hundred Dolars ($31,767,500). • • • [Emphasis supplied.]

It is clear from the foregoing provisions that the parties agreed that White Motor would pay the sum of $31,767,500 of the purchase price by the delivery of 655,000 shares of its common stock, thereby placing a value on the stock of $48.50 per share.

Assignments of value to property by parties with adverse interests in a transaction are regarded as strong evidence by the courts in determining fair market value of the property because fair market value by definition is "the price which property will bring when offered by a willing seller to a willing buyer, neither being obligated to buy or sell." *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U.S. 37, 39 (1937); see *In Re Williams' Estate,* 256 F.2d 217, 218 (C.A. 9, 1958), affirming a Memorandum Opinion of this Court.

In two cases strikingly similar to the instant case, *Moore-McCormack Lines, Inc.* (Mooremac), 44 T.C. 745 (1965), and its companion case *Seas Shipping Co., Inc.*

(Seas), T.C. Memo. 1965-240, aff'd. 371 F.2d 528 (C.A. 2, 1967), certiorari denied 387 U.S. 943 (1967), the issue before this Court was the valuation of 300,000 shares of Mooremac's [208] common stock given to Seas in partial payment for ships Mooremac purchased from Seas. The sales agreement assigned a value of $30 per share for purposes of satisfying the purchase price assigned to the ships. This Court in both cases held that the fair market value of the stock was $30 per share despite the fact that the stock traded for an average mean price of $22.81 on the New York Stock Exchange on the dates of sale. In *Seas Shipping Co.* v. *Commissioner,* 371 F.2d 528 (C.A. 2, 1967), certiorari denied 387 U.S. 943 (1967), the Second Circuit affirmed this Court's valuation and stated at page 532:

> In section 7(b)(5) of the sales contract, which provided for the release of consideration to Seas by the escrow agent as the ships were delivered, the parties themselves assigned a value of $30 per share to the stock. Where parties with adverse interests are at issue over the worth of property and then agree upon the dollar amount of that worth, the agreement is very persuasive evidence of value. *Ullman* v. *Commissioner of Internal Revenue,* 264 F.2d 305, 308 (2 Cir. 1959).

Similarly, in *Southern Natural Gas Co.* v. *United States,* 412 F.2d 1222 (Ct. Cl. 1969), the question before the court was the fair market value of stock transferred by a corporation to its creditors for services rendered. An agreement between the corporation and its creditors valued each share of stock at the equivalent of $90 worth of services rendered. Security analysts, however, testifying on behalf of the Government, valued each share of stock as low as $5. The court held that the best evidence of fair market value was the parties' agreement and accordingly valued the stock at $90 per share.

In *Estate of Gordon A. Stouffer*, 30 T.C. 1244 (1958), reversed on other grounds sub nom. *Commissioner* v. *Marshman*, 279 F. 2d 27 (C.A. 6, 1960), certiorari denied 364 U.S. 918 (1960), reversal disapproved *United States* v. *Davis*, 370 U.S. 65 (1962), the issue before this Court was the valuation of certain stock purchase options granted in a property settlement pursuant to a divorce. In determining the fair market value of the options this Court held the parties' agreed valuation of the options would control the Federal income tax consequences of the transaction, stating at page 1249: "if the parties placed a valuation on the stock and dealt in the stock at a valuation they fixed, the measure of * * * rights which were relinquished would be measured by that fixed value." In its holding, this Couurt quoted the following language from *Commissioner* v. *Patino*, 186 F.2d 962 (C.A. 4, 1950), affirming 13 T.C. 816 (1949):

> It is entirely proper for parties to a contract to make their own estimates of values; and if they are dealing at arms [sic] length and there is no reason to question the bona fides of the transaction, their valuations may be accepted as correct.* * *

Thus, it is well established that when a monetary value is assigned to property exchanged in an arm's-length transaction and such value [209] has economic significance in the transaction, the assigned value of the property is given great weight by the courts in determining the fair market value of the property. *Seas Shipping Co.* v. *Commissioner*, 371 F. 2d 528, 532 (C.A. 2, 1967); *Southern Natural Gas Co.* v. *United States, supra; Ullman* v. *Commissioner*, 264 F. 2d 305, 308 (C.A. 2, 1959), affirming 29 T.C. 129 (1957). Cf. *Paul A. Johnson*, 39 T.C. 473, 480, 481 (1962); *Aleda N. Hall*, 9 T.C. 53 (1947); *Hugh M. Matheson*, 31 B.T.A. 493 (1934), affd. 82 F.2d 380 (C.A. 5, 1936).

The assigned valuation of the White stock in the agreement is accordingly given great weight in our determination of the fair market value of the stock because the

record in the instant case clearly establishes that White and Old Oliver were knowledgeable parties with adverse interests who dealt at arm's length and that the assigned valuation had economic significance in the transaction.

Both White Motor and Old Oliver were publicly held companies with their stock listed on the New York Stock Exchange. White Motor was a leading manufacturer of trucks and Old Oliver was a leading manufacturer of farm equipment. In the negotiation both corporations were represented by sophisticated and experienced negotiators.

Mailman was Old Oliver's principal negotiator and a member of that corporation's board of directors. Since 1932 he had been a partner in Mailman Brothers, a private investment firm in New York City. Prior to the White negotiations he had represented parties in the purchase or sale of businesses or assets on approximately 50 occasions, including a number of transactions involving assets worth $30 to $50 million. Mailman also had a substantial personal interest in the instant transaction since he and his brother, their wives, and corporations they controlled were Old Oliver's largest shareholder group, owning in excess of 12 percent of its outstanding shares.

Dragin, White Motor's principal representative in the negotiations, was a certified public accountant and executive vice president of finance and administration of that corporation. He had previously participated in a number of asset acquisitions by White Motor. Mailman regarded Dragin's business acumen very highly describing him as "probably the most astute negotiator that I have run into a lifetime and a brillant accountant."

The parties unquestionably had adverse interests in the transaction and their valuation of the stock had economic significance. A high valuation of the stock would favor White by requiring a lesser number of its shares to purchase the assets, whereas a low valuation would benefit Old Oliver by increasing the number of shares or amount of cash it would receive for its assets.

Hess argues that the stock valuation was not intended to place a fair market value on the stock because the transaction was essentially [210] an asset for stock exchange. It argues that the function of the valuation was solely to determine a cash adjustment necessary because of the fluctuations which would occur in Old Oliver's inventory prior to the actual sale. In support of this argument it cites *Luther Bonham,* 33 B.T.A. 1100 (1936), affd. 89 F.2d 725 (C.A. 8, 1937). In that case the taxpayer agreed to exchange 1 share of bank stock he held for either 4 shares of the stock of the acquiring corporation or $360 in cash, but each bank shareholder was required to take at least 3 shares of corporate stock and could not take more than $90 cash.

In holding that the agreement did not establish the fair market values of the stocks this Court stated at page 1105:

> While it might be argued that this stock was valued at $90 per share under the contract, it is apparent that that figure was used as the basis of exchange and not as an indication of fair market value at a given date. The contract did not give the petitioner the privilege of receiving $360 per share for his bank stock, but required him to accept a minimum of three shares of Northwest Bankcorporation stock and a maximum of cash in the sum of $90. • • •

We reject Hess' contention that the sales agreement in the instant case did not place a value on the stock. The *Bonham* case is distinguishable because this Court recognized in that case that the $360 figure placed on each share of bank stock and the $90 figure placed on the corporate stock did not represent the parties' appraisal of their value. In fact, neither petitioner nor respondent in the *Bonham* case contended that the figures placed on the stocks in the contract represented the parties' appraisal of the fair market value of the respective stocks. The values placed on the shares were

simply a technique for fixing the maximum portion of the consideration to be paid in cash for each share of bank stock.

In the instant case, it is clear that the value assigned the White stock represented the parties' appraisal of the fair market value of the shares. The parties explicitly valued the stock at $31,767,500 for the purpose of satisfying the agreed purchase price of the assets. Furthermore, the purchase price may have been greater or less than the agreed value of the stock. In the latter case, under the agreement Old Oliver would have been required to pay White the difference in cash. At trial Mailman admitted that inventory sales by Old Oliver could have caused this difference to be as much as $5 million. In such event Old Oliver would have purchased for cash over 100,000 shares of White stock at $48.50 per share. Given that possibility it seems clear that the parties equated the stock valuation with cash and that Old Oliver valued the White stock at least at $48.50 per share.

The facts noted above clearly establish that the valuation of the White stock was reached by knowledgeable parties through arm's-length [211] bargaining. That being so, Hess must offer "strong proof" in order to overcome that valuation.[2] Cf. *Ullman* v. *Commissioner,* 264

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[2] White urges that we should apply the more stringent standard of proof enunciated by the Third Circuit in *Commissioner* v. *Danielson,* 378 F. 2d 771 (C.A. 3, 1967), against Hess because an appeal by Hess lies to the Third Circuit. Under the *Danielson* rule, "a party can challenge the tax consequences of his agreement as construed by the Commisioner only by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc." 378 F. 2d at 775.

We need not decide whether the *Danielson* rule is applicable to the instant case because we find that the evidence adduced by Hess does not satisfy the less rigorous "strong-proof" rule.

F. 2d 305 (C.A. 2, 1959); *Glen W. Lucas, Jr.*, 58 T.C. 1022, 1032 (1972); *Meyer Mittleman*, 56 T.C. 171, 177 (1971), affd. 464 F. 2d 1393 (C.A. 3, 1972). The "strong-proof" rule requires that the taxpayer attacking an assigned value in an agreement to which he was a party prove that the valuation had no basis in fact or business reality and did not represent the actual intention or agreement of the parties. *Edmond E. Maseeh*, 52 T.C. 18, 22 (1969); *Schulz* v. *Commissioner*, 294 F. 2d 52, 55 (C.A. 9, 1961), affirming 34 T.C. 235 (1960). The rule does not ordinarily apply against the respondent, but it is applicable where, as in the instant case, both parties to an agreement are before the court in a consolidated proceeding and the respondent adopts the position of a stakeholder. *J. Leonard Schmitz*, 51 T.C. 306, 316 (1968), affirmed sub nom. *Throndson* v. *Commissioner*, 457 F. 2d 1022 (C.A. 9, 1972); cf. *Schulz* v. *Commissioner, supra* at 55.

Though the usual application of the "strong-proof" rule is to an assigned valuation of a covenant not to compete in a sales agreement, the rule is equally applicable to the instant transaction where the parties assign a value to shares of stock. *Seas Shipping Co.* v. *Commissioner*, 371 F. 2d 528, 533 (C.A. 2, 1967) (Friendly, *J.*, concurring). Cf. *Estate of Rogers* v. *Commissioner*, 445 F. 2d 1020, 1021 (C.A. 2, 1971), affirming per curiam a Memorandum Opinion of this Court.[3] In both instances, the antithetical interests of the parties operate to insure that their valuations are realistic and meaningful.

Upon consideration of the entire record, it is our conclusion that Hess has failed to establish by "strong proof" that the fair market value of the White stock was less than its assigned valuation in the agreement. In fact, on balance we believe the evidence supports the parties' valuation.

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[3] See also *Estate of Rochester H. Rogers, T.C.* Memo. 1970-192.

Hess relies principally on statements made by Old Oliver and White Motor in attempting to prove that the parties did not intend to assign a fair market value to the White stock in the agreement, but merely provided for a cash adjustment in a stock for asset exchange.

It is true that both Old Oliver and White Motor referred to the [212] current stock market price rather than the value assigned the stock by the agreement in their press releases and letters to their shareholders. It is also true that both corporations indicated in their proxy statements that the assigned value of White Motor stock would be adjusted to its market value on the closing date, and in fact initially recorded the transaction on that basis. However, these statements do not convince us that the parties did not assign a fair market value to the stock in the agreement.

The proxy statements of both White Motor and Old Oliver also stated that the 655,000 shares of stock would be valued at $31,767,500 ($48.50 per share), and that fluctuations in the market price of the stock would not change the agreed valuation. The references to current market prices of the shares in White Motor's communications to its shareholders were requested by the Securities and Exchange Commission. Dragin testified that White's preliminary book entries and footnote in its proxy valuing the assets on the basis of the median price of the stock on the New York Stock Exchange were the result of its initial belief that this valuation was required for tax and accounting purposes, irrespective of any agreement by the parties. These book entries were changed to the valuation assigned in the agreement before its books were closed and the audit of the transaction completed, as a result of a review of the purchase by its tax department and accounting firm.

It would be difficult to believe that the statements relied on by Hess indicate that the parties changed the agreed value of the White stock. There is no evidence in the record of any communication between the parties altering

the assigned value. Both parties testified that they had no agreement or discussion with respect to the treatment of the transaction for accounting or Federal income tax purposes.

An analysis of the course of the negotiations indicates that the parties assigned a fair market or cash value to the White stock in the negotiations. Old Oliver initially desired only cash for its assets, and its own board of directors later assigned the $48.50 value to the White stock.

If White Motor had been able to raise sufficient cash to complete the transaction on the basis of the parties' tentative agreement of June 1960 (500,000 shares of White stock valued at $48.50 per share plus cash or debentures), Old Oliver would have received more than $9 million (over 25 percent of the total consideration) in cash or debentures, a sum too substantial to allow a finding that the parties were negotiating solely on the basis of stock for assets.

When White Motor was unable to raise the cash, Old Oliver agreed to accept an additional 155,000 shares of White stock at the assigned [213] value of $48.50 in lieu of cash or debentures in that amount, when the stock was trading at a lower price on the New York Stock Exchange. This makes it very evident that Old Oliver equated the assigned value of the stock with cash and believed the shares were worth that amount.

Finally, on October 28, 1960, Old Oliver's board of directors passed the following resolution acknowledging that the terms of the sale were in accordance with the agreement:

> RESOLVED that the directors of the Company *deem the sale of assets to The White Motor Company, in accordance with the Agreement dated October 3, 1960,* between the Company and The White Motor Company, upon *the terms and conditions and for the consideration stated in said Agreement,* to be expedient and for the best interests of the Company. [Emphasis supplied.]

In some situations where stock is exchanged for property pursuant to an arm's-length agreement the courts have appraised the stock by equating its value with the value of the property exchanged therefor. *Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184, 189 (Ct. Cl. 1954); *Bar L Ranch, Inc.* v. *Phinney,* 426 F. 2d 995, 1000 (C.A. 5, 1970); *Moore-McCormack Lines, Inc.,* 44 T.C. 745, 757 (1965); *Amerex Holding Corporation,* 37 B.T.A. 1169, 1191 (1938), affd. 117 F. 2d 1009 (C.A. 2, 1941), certiorari denied 314 U.S. 620 (1941). An appraisal of the assets received by White Farm supports the valuation assigned the White stock in the agreement.

The assets acquired by White Motor consisted almost entirely of fixed assets (land, building, machinery, etc.) and inventory. The fixed assets were purchased at generally 80 percent of their book value. Mailman testifed that the book value of these assets was low "because some of these buildings are old and well depreciated." In June 1960, Kriser, an experienced appraiser and auctioneer of industrial property, prepared a liquidating appraisal of a portion of the fixed assets subsequently acquired by White Motor under the agreement for approximately $9 million (80 percent of book value). In his report he concluded that assets could be liquidated for $7,750,000. At trial he testified that the fair market value of these assets at that time was over $10½ million.

Old Oliver's inventory was acquired by White Motor under the agreement for approximately $18½ million (80 percent of its book value). The inventory had a low book value because Old Oliver computed its inventory on the LIFO method of accounting. On October 31, 1960, the inventory sold to White Motor had a book value of $23,777,820, but a replacement value of $31,745,068. Thus, White Motor purchased the inventory at a discount of over $12 million from current manufacturing costs.

It is evident that the fair market value of the assets acquired by White Motor was at least equal to the purchase price set forth in the [214] agreement and, accordingly, by equating its value to the value of the White stock, strongly supports the value assigned the shares.

In our determination we have rejected the argument of Hess and respondent that the best evidence of the fair market value of the White stock is its mean trading price on the New York Stock Exchange on the closing date, October 31, 1960. It is true that stock market quotations have been held to be the best evidence of value of a traded stock in a number of cases. *W. T. Grant Co.* v. *Duggan,* 94 F.2d 859 (C.A. 2, 1938); *Hazeltine Corporation* v. *Commissioner,* 89 F. 2d 513, 518 (C.A. 3, 1937), reversing on another issue 32 B.T.A. 110 (1935); *Black Hills Power & Light Co.,* 14 T.C. 1425 (1950); *Estate of Caroline McCulloch Spencer,* 5 T.C. 904 (1945); *Augustus E. Staley,* 41 B.T.A. 752 (1940); *Estate of Leonard B. McKitterick,* 42 B.T.A. 130 (1940). However, we note that in none of these cases cited by Hess and respondent was there an arm's-length agreement between the parties valuing the stock transferred in the transaction.[4] Further, stock exchange quotations are not the best evidence of value in all cases. *Ray Copper Co.* v. *United States,* 268 U.S. 373 (1925); *Heiner* v. *Crosby,* 24 F. 2d 191 (C.A. 3, 1928); *Moore-McCormack Lines, Inc.,* 44 T.C. 745, 759 (1965); *Stollberg Hardware Co.,* 46 B.T.A. 788, 795 (1942); cf. *Bar L Ranch, Inc.* v. *Phinney,* 426 F. 2d 995 (C.A. 5, 1970). As the Third Circuit stated in *Heiner* v. *Crosby, supra*:

> Sales made at a particular time and place may be significant, but the price paid is not necessarily decisive of fair market price or value. The fact of sales, in itself and without regard to the circumstances under which the sales were made, does not conclusively establish either statutory fair market price or value. Sales made under peculiar and unusual circumstances, such as sales of small lots, forced sales, and sales in a restricted market, may neither signify a fair market price or value, nor serve as the basis on which to determine the amount of gain derived from the sale. • • • [24 F. 2d at 193.]

[4] See *Estate of W. E. Telling,* a Memorandum Opinion of this Court dated June 28, 1944, where the Court held that negotiations for the sale of stock at a price in excess of the stock's trading price on the Cleveland Exchange controlled the fair market value of the stock for estate tax purposes.

In *Moore-McCormack Lines, Inc.* (Mooremac), *supra,* and its companion case, *Seas Shipping Co., Inc.,* T.C. Memo. 1965-240, this Court refused to apply the trading price of Mooremac shares on the New York Stock Exchange in determining the fair market value of a block of that stock stating:

> sales in 100-share lots under ordinary circumstances on a stock exchange may not serve as a reliable yardstick or measure of value in the very extraordinary circumstance of the issuance of 300,000 shares representing over 13 percent of the outstanding stock of a corporation and almost twice as many shares as were traded in the entire year of issuance. See *Maytag* v. *Commissioner,* 187 F. 2d 962 (C.A. 10, 1951), affirming a Memorandum Opinion of this Court; accord, *Safe* [215] *Deposit & Trust Co. of Baltimore,* 35 B.T.A. 259 (1937), affd. 95 F.2d 806, 812 (C.A. 4, 1938); *James Couzens,* 11 B.T.A. 1040, 1161 ((1928). [44 T.C. at 759.]

For similar reasons, we have declined to value the White stock on the basis of its trading price. The 655,000 block of White stock was far in excess of the 444,000 shares traded on the New York Stock Exchange during all of 1960. Only 3,300 shares of White shares were traded on the date of sale, October 31, 1960. The trading price on that date of about $36 was the lowest price at which that stock traded in 1960 and 1961. With the exception

of the last 4 months in 1960, the stock traded near or above $48.50 per share, the value assigned in the agreement, during those 2 years. In view of these circumstances, we believe that the value assigned the White stock in the agreement and negotiated by the parties at arm's length constitutes a much more reliable measure of the value of those shares.

We have also rejected the appraisals of the White stock by the expert witnesses of Hess and respondent. Their appraisals were essentially a determination of what a block of 655,000 shares of White stock would have sold for on the date of sale, October 31, 1960. Their valuations were made on the basis of simulated secondary distributions, in which the October 31, 1960, New York Stock Exchange trading price was discounted to account for the large number of shares in the block. We are of the opinion that a valuation based on a reasonable period of time rather than 1 day would have been more meaningful. *Richardson* v. *Commissioner,* 151 F.2d 102 (C.A. 2, 1945), affirming a Memorandum Opinion of this Court, certiorari denied 326 U.S. 796 (1946); cf. *Estate of Gordon A. Stouffer,* 30 T.C. 1244, 1250 (1958). As the Second Circuit stated in *Richardson* (151 F.2d at 103):

> in cases in which evidence as to actual sale prices is the dominant or even the exclusive factor relied upon in making a valuation, nothing in the law or common sense requires the trier to attempt to ascertain what the property in question would have fetched at a sale through a sales effort begun and ended on the critical date. Surely the fair market value of, say, a residence is not measured by the price which the owner could have obtained for it on the very day upon which he first decided to sell. Rather, the measure there, as in the case here, is what *"a skillful broker could within a reasonable period have realized."* • • • [Emphasis supplied.]

We also question the applicability of a simulated secondary distribution to the instant transaction. Under the terms of the agreement, Old Oliver would have been unable to dispose of the stock on the date of sale, but rather would attempt to distribute the shares to its shareholders at a future date. We therefore find little analogy between the situation in which a large block of shares is made available for purchase by undetermined investors, with its resultant depressing effect on the market price, and the situation in the instant case in which one [216] willing buyer purchases the entire block of shares in a single negotiated transaction.

Because of concessions,

Decisions will be entered under Rule 50.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 74-1633

AMERADA HESS CORPORATION, Successor by merger to Hess Oil & Chemical Corporation (J. D. Callendar Financial Vice-Pres.) 1 Hess Plaza, Woodbridge, New Jersey

v.

COMMISSIONER OF INTERNAL REVENUE
Amerada Hess Corporation,

Appellant

No. 74-1634

AMERADA HESS CORPORATION, Successor by merger to Hess Oil & Chemical Corporation (Harold N. Bast, Vice-Pres.) 1 Hess Plaza, Woodbridge, New Jersey 07095

v.

COMMISSIONER OF INTERNAL REVENUE
Amerada Hess Corporation,

Appellant

No. 74-1635

WHITE FARM EQUIPMENT COMPANY, a Delaware corporation (Successor to Oliver Corporation, a Delaware corp.)

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellant

SUR PETITION FOR REHEARING

Present: SEITZ, *Chief Judge,* and VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN, HUNTER, WEIS and GARTH, *Circuit Judges*

The petition for rehearing filed by White Farm Equipment Company, appellee in No. 74-1645, having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges in the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By The Court:—
Van Dusen
Circuit Judge

Dated: June 19, 1975

APPENDIX D

[528] SEAS SHIPPING COMPANY, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 72, Docket 30392.

United States Court of Appeals
Second Circuit.
Argued Dec. 1, 1966.
Decided Jan. 16, 1967.

Before FRIENDLY, SMITH and ANDERSON, Circuit Judges.

[529] ANDERSON, Circuit Judge:

On March 1, 1957, the taxpayer, Seas Shipping Company, Inc., sold ten ships to Moore-McCormack Lines, Inc. [hereafter Mooremac] for $5,466,668 in cash and notes and 300,000 shares of Mooremac stock. In computing the amount realized from the sale, the taxpayer assigned a fair market value of $19.90 per share to the Mooremac stock. Mooremac resold two of the ships during 1957; and in computing its cost basis relative to the capital gains on the sales of the ships, Mooremac placed a value of $30 per share on the stock. The Commissioner determined deficiencies in the 1957 returns of both the taxpayer and Mooremac, both of whom appealed, and in due course the two matters were heard and decided by the Tax Court. The commissioner did not assert any particular value for the Mooremac stock but took the position that the value had to be the same in both cases. The Tax Court handed down two separate decisions and found as a fact in each

case that the value of the stock was $30 per share.[1] The taxpayer has petitioned this court for review of the judgment against it. We affirm.

The Tax Court found that the sale of the ships was an arm's length transaction between knowledgeable parties and therefore appraised the stock by equating its value (plus cash and notes) with the value of the ten ships. To a very large extent it relied upon the evidence of the worth of the ships which it found in the sales contract itself. Although the taxpayer and Mooremac had put no total sales price in the contract, that instrument contained a list of individual dollar values for each ship; these values governed the parties' escrow arrangement, the possibility of *force majeure,* and the removal of ships from the transaction at Mooremac's option. Independent appraisers testified that the 1957 fair market value of the individual ships was as high or higher than the values listed in the contract. When Mooremac resold two of the ships during 1957, it received more than the values listed in the contract; and when the taxpayer sold two other ships, which had been removed from the transaction with Mooremac, it received more for each ship than the values earlier listed in the contract for the same vessels. The Tax Court, therefore, added together the individual ship values listed in the contract, subtracted the amount of cash and notes, and equated the result—$9,000,000—with the total value of the 300,000 shares.

While under the circumstances of this case the Tax Court's adoption of this method of valuation—the equation of two sides of a barter—is not clearly erroneous, it is a means which should be used only under certain limited conditions. The authority for it comes almost exclusively

[1] The Tax Court decision in the present case appears at 24 CCH Tax C.Mem. 1222 (1965). The companion case is Moore-McCormack Lines, Inc., 44 T.C. 745 (1965). The opinion in the present case incorporates the findings of fact in the Moore-McCormack case to a substantial degree.

from cases involving valuation of property for which there is little or no market;[2] for example, the leading case of United States v. Davis, 370 U.S. 65, 82 S.Ct. 1190, 8 L.Ed. 2d 335 (1962) involved the purchase by a taxpayer of his ex-wife's inchoate marital rights in his property. There are obvious dangers in evaluating the consideration involved in one side of a barter by determining the worth of the consideration on the other side. In the first place, the two sides of the barter may, for various reasons, not be equal in value. Secondly, the barter-equation method is in the nature of a bootstrap operation since there is usually no [530] logical reason to start with one side rather than the other. The Tax Court might have valued the Mooremac stock first by looking to its trading price on the New York Stock Exchange and then used that figure to compute the fair market value of the ten ships. Thirdly, the evidence on the value of one side of a barter may be no more reliable than that on the value of the other side. The determination of value by this means is particularly complex in a case such as this where the consideration moving from the seller, for example the ships transferred by Seas Shipping, became a part of the assets of Mooremac, the corporate purchaser, in which, as part of the transaction, the seller, Seas Shipping, became a 13% owner. There is nothing to indicate that the Tax Court gave any consideration to this factor.

Although there was a market for Mooremac shares on the New York Stock Exchange which the Government's stock valuation experts considered satisfactory for estab-

[2] United States v. Davis, 370 U.S. 65, 82 S.Ct. 1190, 8 L.Ed.2d 335 (1962); Philadelphia Park Amusement Co. v. United States, 126 F.Supp. 184, 130 Ct. Cl. 166 (1954); United States v. General Shoe Corp., 282 F.2d 9 (6 Cir. 1960); Addressograph-Multigraph Corp., 4 CCH Tax Ct. Mem. 147 (1945); Raymond A. Hall, 10 CCH Tax Ct. Mem. 599 (1951); Jefferson Livingston, 18 B.T.A. 1184 (1930); cf., International Freighting Corp. v. Commissioner of Internal Revenue, 135 F.2d 310 (2 Cir. 1943).

lishing fair market value, the Tax Court rejected these sales as having no determinative weight in proving the value of the shares. During 1957 they were traded on the New York Stock Exchange at an average price of $22.81; the total trading volume for the year was 166,000 shares, and the annual high was $25.25. If the taxpayer had resold its 300,000 shares at once, it probably would have received less than the trading price for small volumes—a phenomenon known as "blockage"—since 300,000 shares did not represent a controlling interest. It is for this reason that the taxpayer contends that the correct fair market value of the shares was $19.90.[3] The Tax Court, however, rejected the use of the trading price and blockage as determinants on the ground that an annual market of 166,000 shares was too "thin" to fix the value of a block of 300,000 shares. The court reasoned that a block of that size was worth much more than the sum of the trading prices of 300,000 individual shares because that number of shares constituted a 13% ownership in a successful corporation and was the largest block held by any Mooremac shareholder. The court also thought that the value of the shares to taxpayer was enhanced by virtue of a contemporaneous voting trust agreement which it made with certain Mooremac shareholders by which the taxpayer received control of two directorships on Mooremac's board of ten for a period of five years in return for its promise to vote its shares for the other eight in support of directors selected by the other parties to the agreement. In addition, Mooremac had agreed to continue, under the same name, the shipping line previously operated by the taxpayer and to hire certain of

[3] The Tax Court disregarded blockage on the ground that the taxpayer-shareholder had no need or intention to liquidate its holdings. The court's underlying assumption—that fair market value is a subjective quality varying with the particular owner of the property—is incorrect. However, there would be no blockage in this case if there were a willing buyer—one who wanted to buy a block of 300,000 shares.

the taxpayer's employees.[4] Finally the court noted that the book value of Mooremac shares during 1957 was in excess of $39.

The Tax Court also attached evidential weight, as admissions by Seas Shipping, to a report made by Mooremac to its shareholders, which was part of the stipulated evidence in the present case, in which Mooremac stated that its stock was worth $30 a share. The court similarly treated (1) a representation made by Mooremac to the New York Stock Exchange that the stock transferred to Seas Shipping had a value of $30 a share; and (2) a statement made by Mooremac in a letter to Seas Shipping which referred to the price of the ships in dollars only. These last two items are not in the evidence nor do they show up [531] anywhere in the record of this case. It appears that they were arbitrarily lifted, together with numerous other findings, out of the companion case of Moore-McCormack Lines Inc. v. C. I. R., 44 T.C. 745 (1965), in which counsel for Seas Shipping participated for limited purposes not related to these statements by Mooremac, but in which Seas Shipping was not a party, and incorporated these findings by reference in the present case. This was unsupported by a stipulation of the parties and was done *sua sponte* by the Tax Court itself.[5] This free-wheeling handling of

[4] The court's treatment of the various "collateral rights" as enhancing the value of the stock is curious. It would appear to operate the other way. That is, if the consideration for the ships was paid in cash, notes, stock and other rights, the greater the value assigned to the cash, notes and other rights, the less would be the value assigned to the stock.

[5] In its opinion the Tax Court made the following statement as to its treatment of the two cases:

> "While the record in the instant case contains evidence not introduced in the *Moore-McCormack* case which does tend to support the view of petitioner herein that the value of Mooremac stock was less than $30 per share, and although we have given independent

the cases has resulted in an incomplete and somewhat disorderly record on review of this case. The petitioner objects that all of these items are unilateral statements by Mooremac and should not have been used against Seas Shipping. Concerning Mooremac's report to its shareholders, the record is barren of any evidence of ratification of or acquiescence by Seas Shipping in the statement, and the other two evidentiary matters were taken from a case in which Seas Shipping was not a party. They should not, therefore, have been considered as admissions by the taxpayer.

Also the Court considered the fact that the Maritime Board in its approval of the sale of the ships, stated that the value of the stock was $30 per share. The parties in their briefs interpreted the Tax Court's references to the Maritime Board's approval of the agreement of sale as a conclusion of experts on the value of Mooremac stock. If the Tax Court did so, it was in

[5] (Continued)

> consideration to all of the evidence in the instant case in isolation from the evidence presented in the *Moore-McCormack* case, we nonetheless have concluded, and have so found as an ultimate fact, that the Mooremac stock received by petitioner had a fair market value of $30 per share.
>
> We do not deem it necessary to restate here the reasons for our determination. An extensive discussion of the relevant factors is set forth in our report of the *Moore-McCormack,* case, and the reasons for concluding as we do on the record in the instant case are in no material respects different than those set forth in Moore-McCormack."[3]
>
> "[3]. We recognize that in *Moore-McCormack* we relied in part upon facts of record in that case which were not a part of the record in the instant case. However, the absence of such facts in the instant case is not so material as to require a result here different from that reached in *Moore-McCormack* on the stock valuation question."

error. The Maritime Board's own regulation, 46 C.F.R. § 284.2(b)(2), states, "no valuation by the Maritime Administration of a vessel acquired • • • for securities shall be deemed to be a determination • • • of the value of such securities." Also, James Tallman, the official of the Maritime Board who appeared before the Tax Court as a witness, was qualified to testify only as to ship values; and the Board's written statement of the value of the shares, standing by itself, would appear to be incompetent as the opinion evidence of experts on that issue.[6] The Taxpayer, however, has only obliquely raised that point in this court.

If, on the other hand, the Tax Court used the evidence of the approval of the agreement of sale only as proof that Seas Shipping, in accepting the approval, thereby admitted the $30 per share value,[7] then the court was on perfectly sound ground.

While the Tax Court's approach to the valuation of the shares has the infirmities mentioned, it is apparent that the consideration given by the court to the rights accruing to the taxpayer from the contemporaneous voting trust agreement, [532] to the reports by Mooremac to its shareholders and the New York Stock Exchange that the value of the stock transferred was $30 per share, to Mooremac's letter to Seas Shipping to the same effect, and to the valuation of the stock by the Maritime Board at $30 per share, was not a determinative factor in the decision, but was nothing more than additional make-weight. It is wholly unlikely that the exclusion of these items of evidence would have altered the result in any way. Except for Mooremac's unilateral state-

[6] See, e.g., United States v. Certain Parcels of Land, etc., 261 F.2d 287 (4 Cir. 1958), discussing in detail the well established rule that tax assessments are not admissible as evidence of value in condemnation proceedings.

[7] Taxpayer did object to the use of this report as evidence of its acquiescence in the Board's $30 figure.

ments, they were not objected to and are only attacked as part of petitioner's complaint on appeal against the Tax Court's method of evaluating the stock. This court cannot, however, disturb that court's conclusion unless it is clearly erroneous. Maytag v. Commissioner of Internal Revenue, 187 F.2d 962 (10 Cir. 1951).

Although we have found no precedent authorizing the Tax Court to use a barter-equation method where there is an active market for the property to be valued, we cannot say that the court's use of that method in this case was plain error. The character of the small transactions in Mooremac shares on the stock exchange did not reflect many of the aspects of the 300,000 share transfer in question, and we cannot say the Tax Court was clearly wrong in concluding that these small market sales were entitled to little or no weight, certainly not conclusive weight. There was present, therefore, a necessity for the Tax Court to turn to the barter-equation method. Though as more fully stated above we are of the opinion that this method should be used sparingly and with considerable caution, conditions existed which made its use feasible in this case. It is apparent that the evidence persuasively demonstrated the arm's length nature of the exchange and there were also present factors which assured the relative fairness and equality of the considerations passing from each to the other. The testimony concerning the value of the ships was ample and convincing. If the trading price of $22.81 were taken as the stock's value, it would mean that taxpayer had sold its ships for $2,000,000 less than they were worth—a highly unlikely occurrence. Furthermore, there was an additional item of evidence considered by the Tax Court which supported the $30 result reached. In § 7(b) (5) of the sales contract, which provided for the release of consideration to Seas by the escrow agent as the ships were delivered, the parties themselves assigned a value of $30 per share to the stock. Where parties with adverse interests are at issue over the worth of property and then agree upon the dollar amount of that worth, the agreement is very per-

suasive evidence of value. Ullman v. Commissioner of Internal Revenue, 264 F.2d 305, 308 (2 Cir. 1959).

The Taxpayer also seeks review of the Tax Court's decision about another item in its 1957 return. In August 1956, the Commandant of the United States Coast Guard ordered all vessels of a certain type to be "strapped," that is, provided with a reenforcing horizontal steel band attached to the skin of the ship, to give it additional strength and prevent cracking of the hull. During 1957 the taxpayer strapped four of its ships, and deducted the cost as a repair expense. The Tax Court, without deciding whether the strapping increased the value or useful life of the vessel, held that strapping was a capital expenditure and that it was therefore not deductible as a repair expense. The line between capital and current expenses is often a difficult one to draw, and Courts of Appeals should not overturn decisions of the Tax Court on this question unless they are manifestly wrong. P. Dougherty Co. v. Commissioner of Internal Revenue, 159 F. 2d 269, 272 (4 Cir. 1946), cert. denied, 331 U.S. 838, 67 S.Ct. 1515, 91 L.Ed. 1850 (1947). Here the strapping was a nonrecurring expenditure of a purely preventative nature, the benefits of which were to stretch out over the lifetime of [533] the ship. There is no reason to disturb the decision of the Tax Court on that question.

Its decision is affirmed and the petition is dismissed.

FRIENDLY, Circuit Judge (concurring):

While I wholly approve the result reached by my brothers, the case seems much easier to me than it did to the Tax Court or does to them.

When these two companies sat down to negotiate the sale of the Seas Shipping fleet to Mooremac, it must have been obvious to them and their experienced counsel that the seller's interest would be served by a lower and the purchaser's by a higher valuation of the Mooremac stock—

in the case of the latter not only to obtain a high tax basis but for purposes of its operating-differential subsidy, 46 U.S.C. ch. 27, subchapter VI, 46 C.F.R. Part 284. It should have been equally obvious that the Commissioner of Internal Revenue could not be expected to tolerate a state of affairs in which Seas had the benefit of a lower figure and Mooremac of a higher one. The Sales Agreement set values for ten vessels, in addition to the two that were to be paid for in cash, and provided that upon delivery of each, Mooremac stock should be issued to Seas "at the rate of one full share for each $30, or fraction thereof, of value of the Vessels • • •," with any balance payable in cash or serial notes at Mooremac's option. The contract was subject to approval by the Federal Maritime Board and/or the Maritime Administration. The Board's letter of approval endorsed the values the parties had assigned to the vesels and referred to the Mooremac stock as being taken "@ $30.00 per share"; the Board requested each company to signify its "unqualified acceptance." When the parties joined in a telegram asking the Board to delete the figure for the stock and simply refer to the agreement, an official refused, telling Seas' lawyer "that the proposal was unacceptable because of Federal Maritime Board requirements." Seas and Mooremac thereupon returned their acceptance, Seas contenting itself with a letter agreement with Mooremac which confirmed their understanding that the terms and conditions of the basic agreement remained unchanged.

To be sure, none of these arrangements would have precluded the Commissioner, who was not a party, from asserting that the Mooremac stock was not worth $30 per share if he had been so advised.[1] But if he was satis-

[1] The provision in 46 C.F.R. § 284.2(b)(2), "No valuation by the Maritime Administration of a vessel acquired in whole or in part for securities shall be deemed to be a determination by the Maritime Administration of the value of such securities," was doubtless intended to prevent argument on this score.

fied to leave the parties in the bed they and the maritime regulatory agency had made, I fail to perceive any legitimate basis for one of them to complain. The situation is indeed somewhat reminiscent of the tax problems in allocating proceeds of a sale between assets or stock and a covenant not to compete, where, as Judge Waterman said in Ullman v. C. I. R., 264 F.2d 305, 308 (2 Cir. 1959), the tax desires "of the buyer and seller • • • are ordinarily antithetical, forcing them, in most cases, to agree upon a treatment which reflects the parties' true intent with reference to the covenants, and the true value of them in money" so that "strong proof must be adduced • • • in order to overcome that declaration." See, accord, Hamlin's Trust v. C. I. R., 209 F.2d 761, 765 (10 Cir. 1954); Montesi v. C. I. R., 340 F.2d 97, 100 (6 Cir. 1965). This is *a fortiori* true when the parties' declaration has been approved, indeed particularized and insisted upon, by an expert agency of government that has administered the payment of subsidies to both.

APPENDIX E

Chicago Corp. v. *Munds,* 20 Del.Ch. 142, 172 A. 452 (1934):

> "The experience of recent years is enough to convince the most casual observer that the market in its appraisal of values must have been woefully wrong in its estimates at one time or another within the interval of a space of time so brief that fundamental conditions could not possibly have become so altered as to affect true worth. Markets are known to gyrate in a single day. The numerous causes that contribute to their nervous leaps from dejected melancholy to exhilarated enthusiasm and then back again from joy to grief, need not be reviewed. It would be more unfortunate indeed either for the consolidated corporation or for the objecting stockholder if, on the particular date named by the statute for the valuation of the dissentor's stock, viz., the date of the consolidation, the market should be in one of its extreme moods and the stock had to be paid for at the price fixed by the quotations of that day. Even when conditions are normal and no economic forces are at work unduly to exalt or depress the financial hopes of man, market quotations are not safe to accept as unerring expressions of value. The relation of supply to demand on a given day as truly affects the market value of a stock as it does of a commodity; and temporary supply and demand are in turn affected by numerous circumstances which are wholly disconnected from considerations having to do with the stock's inherent worth." 172 A. at 455.